

Practical Auditing

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CHAPTER I.

THE PRINCIPLES OF AUDITING.

§ 1.—The Origin of Auditing.

The practice of Auditing had its origin in the necessity for the institution of some system of check upon persons whose business it was to record the receipt and disbursement of moneys on behalf of others. In the early stages of civilisation the methods of account were so crude, and the number of transactions to be recorded so small, that each individual was no doubt able to check for himself all his transactions; but, as soon as the ancient States and Empires acquired any coherent organisation, records are found of systems of check being applied to their public accounts, the ancient Egyptians, the Greeks, and the Romans, all having utilised systems of check and counter-check as between the various financial officials.

The ancient records of Auditing are confined principally to public accounts, but there is clear indication that from an early date it was customary for an Audit of the accounts of manors and estates to be performed. The person whose duty it was to make such an examination of accounts became known as the Auditor, the word being derived from the Latin *audire*, to hear. Originally the accounting parties were required to attend before the Auditor who *heard* their accounts.

It was not until the 15th century that the great impetus given to trade and commerce generally by the Renaissance in Italy, led to the evolution of a system of account which should be capable of recording completely all kinds of mercantile transactions, and the principles of double entry were first published in 1494 at Venice by Luca Paciolo, although the system had been more or less utilised during the preceding century. It thus became possible to record not only cash transactions, but all transactions involving matters of account, and the duties of the Auditor correspondingly increased.

The increase in volume of trading operations, necessitating the use of more capital than was at the disposal of the average trader, induced him to combine in partnership with others for the purpose of obtaining the requisite capital, and this tendency was a potent factor in the evolution of a more perfect system of accounts.

In the same way no doubt it had a material effect on the practice of Auditing, but the Audit of business accounts did not become common until the 19th century. The enormous increase in trade in that period, which was fostered by the discovery of steam traction and by mechanical inventions generally, led to the formation of numberless Joint Stock Companies, and other corporate undertakings involving the use of large sums of capital under the management of a few individuals. Under these conditions the advantages to be obtained from utilising the services of Auditors became apparent to the commercial public generally, and a great increase in the practice of Auditing resulted, until at the present day it forms the most important part of a Professional Accountant's business.

§ 2.—The Nature and Definition of an Audit.

It has been pointed out that the original purpose of an Audit was principally confined to ascertaining whether the accounting party had properly accounted for all receipts and payments on behalf of his principal, and was in fact merely a Cash Audit ; but the object of a modern Audit, although it includes the examination of cash transactions, has as its ultimate aim the verification of the Balance Sheet of the undertaking ; and, since the Balance Sheet must incorporate in one form or another the balance of the Profit and Loss or Revenue Account, the Audit must extend to the examination of that account also.

An Audit may then be said to be such an examination of the books, accounts and vouchers of a business, as shall enable the Auditor to satisfy himself whether or not the Balance Sheet is properly drawn up, so as to exhibit a true and correct view of the state of the affairs of the business, according to the best of his information and the explanations given to him and as shown by the books ; and if not, in what respects it is untrue or incorrect.

It must not be implied from the above definition that the whole duty of the Auditor is to compare the Balance Sheet with the books in order to see that it agrees therewith. He must do this, but he must also by the exercise of reasonable skill and diligence, satisfy himself that the books themselves contain a proper record of the transactions entered into, as far as his information and the explanations given to him extend. This will involve an examination more or less complete of the whole of the transactions of the business, and the manner in which they are recorded. How far such an examination must extend will depend upon

the individual circumstances of each case, and must be decided by the exercise of the Auditor's judgment. It is sufficient here to say that whatever the extent of the examination, it must be such as will satisfy the Auditor, having regard to whether he is acting under the direct instructions of his clients or under Statute law.

§ 3.—The Objects of an Audit.

The two principal reasons for which an Audit may be instituted are :- -

- (a) The Detection of Fraud,
- (b) The Detection of Errors,

and coincident with these the prevention of fraud and errors by reason of the deterrent and moral effect of the Audit.

(a) The Detection of Fraud.

In the minds of the public at large, and of the majority of clients, the discovery of fraud is so far the principal function of the Auditor as to overshadow his other duties entirely, and there can be no question that it is of primary importance.

Fraud may be divided broadly into two classes :

- (1) Defalcations, involving either misappropriation of money or goods.
- (2) The fraudulent manipulation of accounts not involving defalcation.

As regards the first class of cases, where accounting parties are not subjected to any form of check, the opportunities of committing fraud are so frequent, and the methods necessary to conceal it so comparatively simple, that it is safe to say that no business

of any size could be carried on under such conditions for very long without grave risk of fraud taking place. In businesses of a small nature, where the individual proprietor is in touch with the whole of the detail, and is able to effectually supervise it, the possibilities of concealing fraud may be remote. As soon, however, as the business increases and the proprietor is no longer able to do this, if a check is to be maintained at all it must be carried out either by members of the staff themselves or by an outside Auditor. 'Where the staff is sufficiently numerous to enable the whole of the work to be checked efficiently by members thereof, other than those who carried it out in the first instance, what is known as an Internal Check comes into operation, and the first business of the Auditor should be to carefully examine the system in force, and ascertain its deficiencies, if any. The strength of a chain is the strength of its weakest link, and the same may be said of a system of Internal Check.

The Auditor, therefore, should pay particular attention to those classes of transactions which offer special facilities for fraud, the principal of which are Cash transactions of one kind or another.

As general principles only are under consideration here, the actual way in which these transactions should be verified will be dealt with in due course, but it may be noted that there are two methods by means of which misappropriation of moneys may be concealed; the first by the inclusion of fictitious payments; and the second by the omission of receipts, the latter class being much the more difficult to detect.

The amount of detail checking which the Auditor must perform before he can satisfy himself that no

fraud exists, will depend to a great extent on the system of Internal Check in operation. Where that system is good, collusion between two or more persons must be involved before fraud can remain undetected. Collusion is not infrequent, and cases of it occur from time to time ; but, though certain individuals may not themselves be inherently honest, they see the force of the proverb that "Honesty is the best policy." Such a person might consider it more to his advantage, when approached by a fellow clerk with a view to collusion, to report the matter to his principals in order to gain the reward due to a faithful servant, than to participate in the fraud, and incur the risk of discovery, with its resulting consequences. The necessity for collusion, therefore, is a very great safeguard, and one which the Auditor is entitled to rely upon. He must not of course do this indiscriminately, and assume that because there is a good system of Internal Check in operation he need perform no detail checking whatever. He must test the transactions as exhaustively as the circumstances permit, and should he find anything irregular he will then make a complete examination.

The second class of fraud involving the falsification of accounts without corresponding defalcations, is naturally considerably less frequent than the class of fraud above-mentioned, but when it does occur it sometimes involves very large amounts. It may be done for the purpose of bolstering up a business which is in an insecure condition, in order to maintain the confidence of Shareholders or the public ; or it may be done by a Manager for the purpose of increasing the apparent profits of the business, thus showing that he has been successful in his management, and possibly increasing the commission on results payable to him ;

or by Directors for the purpose of enabling them to pay dividends which would otherwise not have been possible. Several notable cases of this sort of falsification have occurred. It need only be pointed out here that this form of fraud is often very ingeniously and skilfully concealed, and is in many cases carried out by persons holding positions of the highest trust, and having the entire confidence of Directors and Shareholders.

(b) The Detection of Errors.

The second object of an Audit may be said to be the Detection of Errors. Often what appear to be in the first instance merely clerical errors, are ultimately found to be due to fraudulent manipulation, and it is therefore important for the Auditor to carefully examine the cause of any error, however slight it may appear to be. The vast majority of errors, however, are *bonâ fide*, and due either to carelessness or ignorance.

Errors may be classified under the following headings :—

- (1) Errors of Omission.
- (2) Errors of Commission.

And these again may be classified as

- (3) Clerical Errors.
- (4) Errors of Principle.

While there is a further type known as

- (5) Compensating Errors.

(1) *Errors of Omission.*

An Error of Omission arises when any transaction is left either wholly or partially unrecorded in the books. If the former, the omission will not affect the

Trial Balance, and will consequently be more difficult to detect. Sometimes it is apparent from the balance of an account that an entry has been omitted; *e.g.* the Rent Account may show that rent for three quarters only has been paid, and no entry may have been made recording the quarter outstanding. This would become apparent as soon as the item of rent was compared with that of previous years, or the Ledger Account examined, but many other cases can be instanced which are much more difficult to deal with; *e.g.* an item of Purchases may be omitted, with the result that the purchases appear as less than they really are, and the Creditors are similarly affected. This could not be disclosed by the Trial Balance, but might appear from an examination of the Ledger Account or the Creditor's Statement. Where only one aspect of the transaction is recorded, the omission will throw out the Trial Balance. This most frequently arises by reason of items not being posted.

(2) *Errors of Commission.*

An Error of Commission arises when a transaction is incorrectly recorded, either wholly or partially. In the former case the Trial Balance may not be affected, but the error should be discovered when the transaction is vouched or otherwise checked; *e.g.* an entry in a Sales Day Book might be made, and the calculation of the value of the goods incorrectly extended. The posting of the incorrect item would be made to the Ledger, and the error would not be discovered until either the calculation was checked or notice received from the customer. If the transaction is partially incorrectly recorded, the result will be to throw the Trial Balance out to that extent; *e.g.* where

an item in the Sales Day Book is posted incorrectly to the Ledger.

(3) *Clerical Errors.*

A Clerical Error is one occasioned by an incorrect posting; or by posting an item to a wrong account, but one of the same class to which it should have been posted; *e.g.* an item might be posted to the debit of A instead of to the debit of B. If therefore the Trial Balance is agreed, all clerical errors of the first kind should have been discovered, unless they are counter-balanced by other errors. Clerical errors of the second kind, even if undetected, should not affect either the amount of profit or the general correctness of the Balance Sheet.

The following are common instances of Clerical Errors which the Auditor should be on his guard against when engaged on books prior to the Trial Balance being agreed:—

1 (a) An item may be posted to the debit instead of to the credit of an account, or *vice versa*. This will throw out the Trial Balance to the extent of double the amount in question; *e.g.* an item of £3 posted to the debit instead of to the credit will have the effect of making a difference of £6 on the Trial Balance.

1 (b) An item of £26. 9s. may be posted as £20. 6s. 9d. This will make a difference of £6. 2s. 3d. in the Trial Balance. This is a very common class of error, and if the difference on the Trial Balance is susceptible of being interpreted in this or a similar manner, all items in respect of which such an error might arise should be rechecked.

(c) Although the casts and postings in a Ledger Account may be correct, the total of each side of the

account may not agree, and consequently the balance of the account will be incorrect. In casting Ledger Accounts and checking down balances a junior Audit Clerk is frequently apt to omit to see that the totals on each side of the Ledger Accounts agree.

(d) Errors often arise in carrying forward totals from one page to another; e.g. £300. 10s. being carried forward as £310, or £189 as £198.

✓(4) Errors of Principle.

An Error of Principle arises by reason of a transaction being recorded in a fundamentally incorrect manner. This is the most important class of error, and one which the Auditor should exercise the utmost care to detect.

Minor errors of principle may not affect the ultimate profit, but arise from revenue items being posted to the wrong class of revenue account; e.g. an item of Manufacturing Wages being posted to Trade Expenses Account; or may consist of Balance Sheet items being posted to the wrong class of asset or liability accounts respectively.

Major errors of principle directly affect the profit, and are occasioned by treating a revenue item as an asset or a liability, or *vice versa*; e.g. treating rent paid as a debtor instead of an expense.

(5) Compensating Errors.

A Compensating Error is one which is counter-balanced by another error or errors, so that it is not disclosed by the Trial Balance. This is a dangerous type of error, which is sometimes difficult to detect. It may or may not affect the profit. If the original error and the compensating error both arise in revenue

accounts, the profit will not be affected, but if one arises in a revenue account and the other in an asset or liability account, although the Trial Balance will agree, the profit will be incorrectly stated. Such errors arise in various ways, but most frequently in casting; *e.g.* the cast of an expenditure account is £100 too small, and the cast of an asset account is £100 too much, the profit and the assets being thereby increased improperly.

§ 4.—Various Classes of Audits, and their Advantages.

It may be convenient here to indicate the principal classes of Audits which are undertaken in practice, and the advantages to be derived therefrom.

(a) Audits under Statute.

Audits are compulsory under Statute in the case of a large number of undertakings, chief amongst which must be placed Limited Companies. The regulations as to the appointment of Auditors and their duties in each of these cases will be dealt with in due course: but the advantages to be derived by the Shareholders and Proprietors of these concerns, from a Professional Audit, are similar in their nature, and may be dealt with from the general point of view of Limited Companies.

It has already been noted that Trading Partnerships arose by reason of the development of trade requiring the utilisation of more capital than was at the command of the individual trader; and, in the same way, Joint Stock Companies supplied the machinery

for utilising, under one management, larger amounts of capital than could be provided by either individuals or partnerships. Such Companies operated originally under Partnership Law, and the liability of each of the members was unlimited. It was impossible, however, to obtain efficient management, and at the same time to permit each individual Shareholder or Partner to exercise the rights of an ordinary Partner, and, as a result, Committees of Management were formed, in whose hands the whole of the operations of the undertaking were placed. Such persons became known as the Directors.

As a result of their position, Directors found themselves in a fiduciary relation to the body of Shareholders, and liable to account to them for all their dealings on behalf of the Company.

The number of Companies of this nature having increased very largely, special legislation on the subject was found to be necessary, and in 1844 the Joint Stock Companies' Registration Act was passed. At this period the liability of each Shareholder was unlimited, and it was not until 1855 that the first Act was passed making it possible for Shareholders to limit their liability. Several other Acts were passed amending the law on the subject, and in 1862 the law was consolidated in an Act, as a result of which Joint Stock enterprise increased very rapidly.

The fact that the whole control of the Company was vested in the Directors, rendered it necessary that some means should be utilised of enabling the Shareholders to be assured that the accounts presented to them by the Board correctly represented the state of affairs of the Company, and that the Directors had not utilised their position for the purpose of mis-

appropriating the funds of the Company or using them for their private gain. It was impracticable, however, for every individual Shareholder to satisfy himself on these points, for as a rule he was not possessed of the requisite technical knowledge, and the right of inspection and enquiry could not be given to one Shareholder without it being granted to all. Consequently it became usual for Shareholders to appoint one or more of their number to act as Auditor or Auditors of the Company, and to report to the Shareholders on their examination of the Balance Sheet and Accounts. Subsequently it was found inadvisable to confine this function to individual Shareholders, who might not be possessed of the requisite qualifications, and it became usual to appoint Professional Auditors to act on behalf of the Shareholders generally. Although for some considerable time the Lay Auditor continued to exist, he is now rapidly disappearing, and the accounts of practically every Company of importance are now audited by Professional Accountants.

Notwithstanding this tendency, which had manifested itself early in the history of Joint Stock enterprise, it is curious to note that the Act of 1862 did not make any provision for the appointment of an Auditor, or for the presentation of accounts to the Shareholders, except in so far as this was done in the Schedule to the Act, known as Table "A," which contained a model set of Articles to be utilised by all Companies not possessing Articles of their own. These regulations contained provisions for the appointment of Auditors and the presentation of accounts, and although the Table did not apply to Companies whose Articles expressly excluded its operation, it became customary for all Companies to make provision by

their Articles for the appointment of an Auditor. It was not, however, until the Companies Act, 1879, was passed that any further statutory reference was made to the appointment of Auditors, and this Act only referred to Banks registered after the passing of the Act, an Audit in these cases being made compulsory. This provision was not extended to all Limited Companies until the Companies Act, 1900, when for the first time it became legally necessary for every Limited Company to appoint an Auditor or Auditors.

The Companies Act, 1907, amended the duties of Auditors as defined in the Companies Act, 1900, and the Companies (Consolidation) Act, 1908, repealed and re-enacted the whole of the Statutes relating to Limited Companies, and finally consolidated the regulations relating to the Audit.

The advantages of a Professional Audit of a Company's Accounts from the point of view of the Shareholders are manifold. It has already been pointed out that it is impossible for individual Shareholders to be familiar with the details of all the various businesses in which they may be interested as Shareholders; moreover, the Articles of Companies do not as a rule permit individual Shareholders to have access to the books and accounts; and consequently, the Shareholders as a body are entirely dependent on the Auditor appointed by them, whose duties are to examine the books and accounts of the Company, and report to them on every Balance Sheet laid before the Company in General Meeting. In addition, the Audit acts as a check upon the Directors, and as a precaution against fraud on the part of employes; whilst the Auditor is often able to render valuable assistance by reason of his expert knowledge in matters of account

and finance generally, though it is not his province to offer advice unless he is asked for it.

In this connection, the functions of the Auditor as apart from the Accountant should be distinguished. It is commonly the custom, particularly with the smaller classes of Companies, to arrange for the Auditor to prepare the final accounts. If he does this, it should be remembered that he acts in his capacity as Accountant, under the instructions of the Directors, and not in his capacity of Auditor appointed by the Shareholders. He may perform other duties than that mentioned in his capacity of Accountant, but in all instances of importance it would seem advisable that he should acquaint the Shareholders that he is acting in this manner as well as in the capacity of Auditor. It would then be for the Shareholders to decide whether he shall continue so to act or not. This particularly applies to cases where the Auditor also writes up the books of the Company.

(b) The Audit of the Accounts of Private Firms.

The Audit of Trading Partnership Accounts has become increasingly frequent as the commercial community have realised the advantages to be derived therefrom. It should be remembered that such duties are not performed under Statute, but under the Deed of Partnership, or by mutual agreement between the partners, and it may be useful to note the essential distinctions between the Audit of a company and the Audit of a private firm. The former is obligatory under Statute, and the rights and duties of the Auditor are defined by Statute; he is appointed by the Shareholders, or by the Directors on their behalf in certain

instances, but they cannot limit his statutory duties, though they can, if they wish, extend them. In the case of a private firm the Auditor is not appointed under Statute, but by agreement between the partners, and his rights and duties are defined by them, and are subject to modification.

In the case of private firms the Auditor frequently acts also in the capacity of Accountant, and although it may be possible for him to distinguish accurately between the work he performs in each of these capacities, the distinction may not be regarded in the same light by his clients. Frequently, where only accountancy work is performed, the client supposes that his books are actually audited, and the responsibility for errors and fraud may in this way recoil upon the Accountant. In order to avoid this, the precise duties of the Accountant should be carefully defined in writing at the outset, so that no dispute can subsequently arise as to the extent of his responsibility. This subject is further dealt with in Chap. XII. § 4, where legal decisions are considered.

In addition to the advantages common to all forms of Audit, viz., the detection of errors and fraud, the Audit of Partnership Accounts is advantageous, inasmuch as it affords a convenient means for settling accounts between the partners themselves, and so of avoiding the possibility of future dispute. It is customary to find provisions in Partnership Deeds arranging for an Audit, and making the audited Balance Sheet, when accepted and signed by them, final as between the partners.

The suggestions which the Auditor is sometimes able to make with regard to the improvement of the system of accounts in use, and the expert knowledge

of accounts at his command, should prove of advantage to the business.

The settlement of accounts resulting on the death or retirement of a partner, or the adjustments arising on the occasion of an incoming partner, are much facilitated when audited accounts form the basis upon which to work; and the same remarks apply to the assessment of the firm for Income Tax, the necessary adjustments relating to the individual partners, and the preparation of their Returns for Super-tax (if any). The growing complexities of Income Tax law make the advantage of professional assistance in this matter particularly noticeable, since an indifferent knowledge of the procedure may result in considerable loss to the taxpayer.

The sale of the business as a going concern, or the negotiation of loans with banks and others, are considerably facilitated where proper accounts have been prepared and audited.

An Audit on behalf of a Sleeping Partner, or a Partner under the Limited Partnerships Act, 1907, is very advisable, since such a person as a rule has little means of checking the accounts of the business, or verifying the share of profits due to him.

In the case of individual traders, the arguments in favour of an Audit are similar to those above set out, with the exception of the points applicable only to Partnerships. In a business of any size, the absence of partners and the impossibility of one man being assured of the correctness of the whole of the detail of his business, render it all the more essential that he should employ Professional Accountants for this purpose.

(c) The Audit of the Accounts of Private Individuals.

It is becoming customary for persons whose incomes are considerable, and whose expenditure is heavy, to have their private accounts audited. Frequently the Auditor in such cases also acts as Accountant, and actually writes up the books.

The advantages to be derived from an Audit of this nature are, in the first place, that the individual is assured of having his accounts properly kept and his expenditure vouched. These considerations particularly apply where the expenditure is incurred in respect of landed property, or the upkeep of large establishments, when it is practically impossible for the proprietor to control personally the payments made. He is obliged to place his trust in individual agents or servants, and to give them the control of moneys, and unless an efficient check is exercised upon their actions, the temptation to defraud is considerable. Secondly, the presentation of accounts prepared on a uniform basis, affords a valuable means of comparison of the various classes of expenditure between one year and another, and where such expenditure exceeds the limits of prudence, it is possible to immediately ascertain the origin of the increase, with the result that steps may be taken to rectify the position. The preparation of Income Tax and Super-tax Returns is also greatly facilitated.

In addition to the cases above-mentioned, there are many other instances where agents are appointed for the purpose of controlling business operations, and the value of an Audit to the principal concerned is particularly apparent when he has no effective check on the accounts of his agent. Instances of this class of Audit are: the Audit of the accounts of an Underwriting Agent at Lloyd's, and the accounts of Rent Agents, Estate Agents, &c.

Private books of account are very useful to Executors and Administrators of a deceased person, and when these books are properly audited they are doubly valuable, inasmuch as the Executor knows that they can be relied upon. They will form the basis for the preparation of the Estate Duty Account, and will save very considerable trouble and expense which would otherwise be incurred if no proper record had been kept of the assets and liabilities of the deceased.

In this connection it may be mentioned that instances have arisen where, through the failure of a person to keep proper books of account during lifetime, great difficulty has been found in ascertaining what assets the testator actually died possessed of, or the extent of his liabilities.

(d) The Audit of Trust Accounts.

The Accounts of Executors and Trustees furnish the occasion for another class of Audit, the advantages of which have been more appreciated in recent years by the general public.

In the majority of cases Executors and Trustees are private persons, sometimes possessing considerable business capacity themselves, and sometimes possessing none at all. The law relating to the administration of Trusts is very complex, particularly in relation to matters of account. The two classes of beneficiaries—Tenants for Life and Remaindermen, to whom the accuracy of Trust Accounts is of supreme importance—are often widows and minors, who cannot criticise the accounts in any effective manner. In a great many cases also the Trustees themselves present no account at all until forced to do so, and even then such a

are, as often as not, incorrect. In other cases the Trustees keep no proper accounts, and this omission often serves to conceal misappropriations of Trust moneys.

For these reasons the advantages of a professional Audit of Trust Accounts, and of a strict verification of the securities composing the Trust are apparent, but until the Public Trustee Act, 1906, came into force, it was very difficult to obtain such an Audit, unless with the consent of the Trustees themselves. The increasing number of scandals, some of great magnitude, arising from the defalcation of Trust moneys, led to the passing of this Act, and the constitution of a Public Trustee. The only point of the Act, however, which need be emphasised here is that which provides machinery for the Audit of the accounts of any Trust, whether commenced before or after the passing of the Act, and whether the Public Trustee is or is not connected with it. An Auditor appointed in such a case must either be a Solicitor or a Public Accountant.

It may be noted that Banking Companies, Insurance Companies, and other corporate bodies have within recent years taken power to act as Executors and Trustees, and recognising the advantages of a professional Audit to the beneficiaries, usually arrange that this shall be performed as one of the conditions on which they are prepared to undertake the Trust.

Private Trustees also recognise the advantages of an Audit in their own interest, since any erroneous treatment in the accounts for which they might be personally liable will be pointed out by the Auditor, and can then be rectified. Further, they are able to consult the Auditor on points of difficulty before action is taken.

§ 5.—The Conduct of an Audit.

(a) Continuous and Final or Completed Audits.

An Audit may involve the whole of the transactions in the books being checked, when it is known as a "Complete" Audit; or it may involve checking only some of the transactions, when it is known as a "Partial" Audit. This latter term is incorrect, since any Audit worthy of the name, must be complete in the sense that the Auditor must satisfy himself as to the correctness of the accounts he is asked to verify. In most businesses of any size, however, the amount of detail is so voluminous, and the time involved in checking the whole of it would be so excessive, that reliance for the accuracy of the detail is, to a large extent, placed upon the system of Internal Check in operation in the office itself, and the Auditor, after making such tests of the detail work as commend themselves to his judgment, is then able to devote his attention to questions of principle.

In any case the Audit may be carried out either continuously, at fixed or unfixed interim dates, or wholly after the completion of the period under review.

(1) *Continuous Audit.*

A Continuous Audit is one where the Auditor's staff is occupied continuously on the accounts the whole year round, or where the Auditor attends at intervals, fixed or otherwise, during the currency of the financial year, and performs an Interim Audit; such Audits are adopted where the work involved is considerable, and have many advantages in their favour, although they are subject to certain disadvantages.

The following are the advantages of a Continuous Audit :—

- ✓(1) More detail checking can be performed.
- ✓(2) The work is checked sooner than would be the case otherwise; errors can be rectified more quickly; and if any fraud has taken place it is discovered sooner. In the latter event there is less time for the defrauding party to operate, with the result that the amount involved may be considerably less than would have been the case if the Audit had not taken place until after the end of the financial period.
- ✓(3) The Audit can be completed more quickly, and the accounts presented at the end of the financial year sooner than would otherwise have been possible.
- ✓(4) The frequent attendance of the Auditor has the effect of causing the staff to keep the work well up to date.
- ✓(5) Where the attendance is at uncertain intervals, the moral check involved is considerably strengthened, as the members of the staff are not aware, from day to day, when the Auditor will attend.

The following are the disadvantages of a Continuous Audit :—

- (1) It is possible for figures to be altered after the Auditor has checked them, either innocently or fraudulently.
- (2) The Audit not being carried on consecutively to a finish, it may be possible for the clerk in charge to lose the thread of the work, and omit to follow up completely transactions which may be left open at the date of his last visit.

These disadvantages, however, can be guarded against in such a way as will minimise the risk involved. A strict rule should be instituted, that no alteration should be made in any figures after the Auditor has once passed them, but that, if necessary, adjusting entries should be made to rectify any error discovered. The fraudulent alteration of figures is somewhat difficult to provide against, and it is advisable for the Auditor to adopt a special "tick" in cases where he checks figures that have been erased or otherwise altered, so that, on a subsequent occasion, he can see that the new figures are the ones actually seen by him. Such alteration in the "tick" should be extremely slight, and be carefully kept secret, though it is to be feared that a clever manipulator would be sufficiently ingenious to discover this arrangement and imitate it.

Fraudulent manipulations in Personal Accounts can most easily be concealed by making compensating false entries in Impersonal Accounts. It is of the utmost importance, therefore, in the case of a Continuous Audit, for the Auditor to make certain that no "juggling" can take place with the Impersonal Accounts which he has already checked; and for this reason, where, as in most cases, the Impersonal Accounts are not excessively voluminous, it may be wise to leave the checking of these accounts until the final Trial Balance is arrived at and the books closed. The work done during the interim period is usually connected with the vouching of the Cash, casting of subsidiary books, and work on the Bought and Sold Ledgers, &c.

In some cases, it may be inconvenient to leave the impersonal work in this way until the end of the period, and, in that event, unless the Impersonal

Ledger is balanced off at the interim periods (which is unusual), the Auditor should take a note of all the totals in the Impersonal Ledger up to the date to which he has checked it, and verify these totals on the occasion of his next visit, in order to see that no manipulation has taken place.

The disadvantage arising from the lack of continuity in the work, and the possibility of points being overlooked in consequence, can be remedied by the exercise of proper care and supervision in the conduct of the work, aided by a judicious use of notes where necessary.

(2) *Final or Completed Audit.*

A Final or Completed Audit is commonly understood to be an Audit which is not commenced until after the books are closed at the end of the financial period, and is then carried forward continuously until completed. This is the most satisfactory form of Audit, and is usually adopted wherever practicable, particularly in the case of small concerns. In large businesses, however, the amount of time occupied by the Audit after the completion of the accounts, is so considerable as to delay the presentation of the final Audited Accounts beyond a reasonable period, and thus defeat one of the advantages of the Audit, viz., that the accounts are audited and reported on as soon as possible after the financial year, in order that the information derived in this way can be utilised for the advantage of the business.

The proprietors are usually anxious for the Audit to be completed as soon as possible after the financial year, and this is rendered essential in the case of

Limited Companies, in order that the Shareholders' Meeting may be held and final dividends declared.

It has been suggested that the most advantageous form of Audit, is to have an Interim or Continuous Audit performed by one Auditor, supplemented by a Final Audit performed by another, though this is prohibitive in most cases, owing to the expense involved. The principle, however, is carried out in theory to a large extent in businesses of any magnitude, where an Audit staff is employed by the proprietors, whose duties are distinct from those of the Book-keepers, and who spend the whole of their time in checking the detail work. This represents the highest development of the principle of Internal Check, and although it has not the same relative value as a detailed Audit by outside Auditors, its efficiency is undoubted if it is properly organised.

(b) **Considerations on the Commencement of a New Audit.**

On undertaking a new Audit, the first care of the Auditor should be to ascertain the precise nature and scope of his duties. In the case of Audits under Statute, the question of the precise nature of the Audit required by the client does not arise, but in other cases the line between Accountancy work and Audit work proper is sometimes so uncertain, at any rate in the minds of clients, that it is advisable for the Auditor to ascertain in the first instance exactly what his client requires, and take care that this is formulated in writing, especially where the Audit is not a complete one.

This information having been obtained, the next step should be to make a careful examination of the system of accounts employed in the office. A

complete list of all books in use should be handed to the Auditor, and where there is a definite system of Internal Check in operation, he should obtain a written statement regarding it.

The names of the principal Officials should also be obtained; together with particulars of the work controlled by each, and the scope of the authority conferred upon him.

From a first general examination of the books in conjunction with the above information, he will be in a position to formulate the principal lines on which the Audit must be conducted, and the direction these will take will directly bear on the efficacy or otherwise of the system of Internal Check.

Taking as an instance the case of a manufacturing business, the special points to which the Auditor should direct his attention in this connection are as follows :—

- (1) The regulations in force relative to the receipt and payment of Cash, and the Cashier's duties ; and particularly whether he is concerned with the writing up of other books of prime entry.
- (2) The methods employed in the preparation of the Wages Sheets, and the manner of payment.
- (3) The regulations in force with regard to the passing and checking of Invoices and Statements.
- (4) The method of keeping and controlling the Petty Cash.
- (5) The manner in which the entries in the Personal Ledgers are checked, and the Balances agreed ; the intervals at which the balancing is effected ; and, in the event of each Ledger being balanced separately, whether the Total Accounts are kept beyond the control of the Ledger Clerk concerned.

The opening Balance Sheet will be examined by the Auditor, and the whole of the balances comprised in it should be checked in order to make certain that the period commenced with the balances as shown in such Balance Sheet. If the accounts have been subject to prior Audit, the late Auditor's Report should be seen, as it may contain material information.

In the event of the business concerned being of a technical nature with which the Auditor is unfamiliar, he will be wise to acquaint himself as much as possible beforehand with the technical details, so that he may be in a position to ask intelligent questions. It is clear that no Audit can be effective unless the Auditor himself grasps the nature of the transactions recorded, and it is essential, therefore, for him to make himself intimately acquainted with the procedure, by following through representative transactions of each class, until he has succeeded in acquiring the necessary knowledge.

• Special considerations arising on the occasion of the first Audit of a Limited Company will be dealt with in Chapter IX.

(c) Audit Note Books.

There is a certain amount of difference of opinion among practising Accountants as to the advantages to be derived from the use of Audit Note Books. In a properly organised office, it is essential that the principals should be perfectly familiar with the work performed on each Audit, so that in the event of the clerk in charge being away or leaving the firm, no difficulty need be experienced in carrying on that particular matter.

It is therefore desirable that some definite record should be kept of the work performed at each Audit,

and in order to ensure uniformity, and to make certain that all the work is done which should be done, it is advisable to make out a programme of work, the clerk responsible for each portion of the work done initialling as it is performed. In this way the progress of the work in the course of the Audit can be ascertained immediately by the principal, and in the event of work being left undone, or errors being passed or made, the responsibility can be allocated to the particular clerk concerned.

On the occasion of the first Audit it is not advisable to draw up a hard-and-fast programme, as the work to be done can really only be decided on as the Audit proceeds. Careful note, however, should be taken of the work performed, and this will afford material for the preparation of an Audit Programme to be followed in the future.

The principal argument advanced against this procedure is, that by laying down a definite plan of work, the initiative of the clerk in charge is to a large extent nullified, and the Audit is apt to become too automatic in its nature. There is no reason, however, that this should be so, and there is nothing to prevent the clerk in charge from making suggestions as to amending the programme, if his experience shows this to be desirable.

As long as the Audit is not allowed to become too automatic, and the programme is changed or revised from time to time according to circumstances, the system suggested has so many advantages that in a business of any size it can hardly be dispensed with in one form or another.

The practice of making notes during the progress of the Audit, apart from a record of the work done,

should not be extended further than is absolutely necessary. It is infinitely preferable to clear up a query and to get rid of it than to make a note of it. Those points, however, which cannot immediately be cleared up should be noted, and an instance of this may be found in the case of missing vouchers, duplicates of which may have to be obtained.

Points of importance also which require to be remembered from one Audit to another, but which are not apparent on the face of the accounts, should be recorded.

On the occasion of the first Audit of a business which is of a technical nature, and where special considerations apply, it is very convenient to make explanatory notes of all transactions of technical difficulty, so that these can be referred to by others who may have to take up the work subsequently.

(d) Method of Work.

The method of work to be adopted on any Audit will naturally vary with the individual training and experience of the Auditor, and with the circumstances of each case. There are, however, one or two points which may be conveniently noted here.

Special "ticks" should be adopted for each class of transaction checked, and the following are the usual classes of "ticks":--(1) Posting, (2) Casting, (3) Carry Forward, (4) Vouching, (5) Pass Book, and (6) Contr'as. The same kind of "tick" is not used by every firm for the same transaction, nor is this perhaps desirable, but a rule should be made in every office that the system of "ticks" adopted must be closely adhered to. It is usual for the Auditor to use some coloured ink, such as red or green, in order to distinguish his "ticks"

from those utilised by the office, and sometimes alternate colours are used for alternate periods.

Each section of the work should be completed, as far as practicable, and cleared definitely to a certain point. The habit of leaving "loose ends," which is a common failing with some Audit clerks, is a very dangerous practice, as it may lead to points being ultimately forgotten or overlooked, or even possibly to fraudulent alterations being made. Fraud has been known to occur where the Ledger Balances had been checked one day and not cast till the next, the Schedules having been in the meantime handed back to the Ledger clerk, who had taken the opportunity of altering the figures already checked by the Auditor. If the casts had been checked in the first instance this could not have occurred.

In the case of Continuous Audits, the work should only be performed up to a fixed date to which the books have been completed. In no case should pencil figures be taken, unless the Auditor chooses to ink in the items himself. The practice of making pencil entries or casts is extremely undesirable, and the Auditor should insist that all such entries are inked in before he commences to work on the books concerned. In checking balances, unless the same are brought down in ink, the Auditor should require the amount of each balance to be noted at the side of the Ledger Account in ink, which preferably should be of some other colour to that used in the body of the Ledger. If this is not done, the Auditor must himself note such balances in ink, in order to avoid the risk of items being inserted afterwards, which would affect the balance.

It is not the business of an Auditor to balance the books, and he must take care to relieve himself of any

responsibility for errors in balancing. Frequently the Auditor is requested to balance the accounts, but, if he does this work, it is in his capacity as Accountant, and not as Auditor, and should be subject to a separate arrangement. The question often arises whether it is advisable for the Auditor to commence the Audit before the books are balanced. Sometimes it is found necessary to do so in order that the Audit may be completed within the required period; but it is not desirable, since it increases very materially the risk of passing errors, as the books have not, in the first instance, been subjected to the clerical test obtainable by the Trial Balance.

§ 6.—The Qualities required of an Auditor.

The general principles of Auditing having been indicated, it may be profitable to point out the essential characteristics which an Auditor must possess if he is to perform his duties efficiently.

In the first instance it is imperative that the Auditor should have a wide knowledge of the theory and practice of Book-keeping and Accounts, and should be so familiar with the underlying principles thereof, that he can apply them without difficulty to transactions of which he has had no previous experience. It is impossible for a man to Audit an account properly unless he is capable of preparing that account himself. The lack of this fundamental requirement, is the principal cause of inefficient auditing, and it cannot be too strongly insisted on, that the only safe rule to adopt is never to pass a transaction if its precise meaning is not understood. Unfortunately this principle is often transgressed by those who, not having

the requisite experience or knowledge, are afraid to ask the necessary questions, and consequently pass the item blindly, trusting to luck that it is in order. Such a habit—for it is apt to become a habit—involves very heavy risks, and is certain to end sooner or later in disaster. It is impossible for everyone to have experience in every class of business, and occasions must from time to time arise, when the Auditor is presented with transactions of a technical nature, of which he has no knowledge.

The proper course for the Auditor to pursue in such circumstances is to ask intelligent questions of his clients or their staff, and thus place himself in possession of the requisite information to enable him to criticise the transaction. The exercise of a certain amount of tact is required, and considerable caution is needed to avoid putting questions which, owing to ignorance of technicalities, would appear ridiculous; but, assuming this to be done, greater respect will be gained by an honest admission of unfamiliarity with the transaction, than by the assumption of knowledge which is not possessed, and the lack of which will be almost certainly discovered.

Lord Justice Lindley said: "An Auditor must be honest—that is, he must not certify what he does not believe to be true, and he must take reasonable care and skill before he believes that what he certifies is true." (*In re London and General Bank* (No. 2), 1895, 2 Ch. 683.)

If there is a difference of opinion between the Auditor and his clients on a matter of importance, he must have the courage of his convictions. He must possess, in some considerable degree, that characteristic of genius—an infinite capacity for taking pains; he

should possess tact and patience ; he must be conscientious, and must not be hurried into signing a certificate or report until he has received the whole of the evidence which he requires, or sign under a promise that evidence required will be forthcoming the next day.

An Auditor must exercise constant vigilance ; he must not allow his work to become automatic, or to lapse into a mechanical routine. He must be accurate, since his function is to detect the mistakes of others ; he must be methodical, in order that no detail of his work may be omitted ; he must be cautious, but he need not be suspicious. As Lord Justice Lopes said : " An Auditor is not bound to be a detective, or, as was said, to approach his work with suspicion, or with the foregone conclusion that there is something wrong." (*In re Kingston Cotton Mill Co. (No. 2)*, 1896, 1 Ch. 331.)

If asked to give his advice in matters of financial policy, or to suggest improvements in the accounts, an Auditor must be prudent, and above all things practical. Theoretical knowledge can often be pushed to excessive extremes, and it must be tempered with a nice appreciation of practical possibilities.

Last, but not least, the Auditor should have a full share of that most valuable commodity—Common Sense.

SYNOPSIS OF CHAPTER II.

The Audit of Cash Transactions.

§ 1 —INTERNAL CHECK AS REGARDS CASH.

- (a) Receipts.
- (b) Payments.

2 —VOUCHING PAYMENTS.

- (a) General Considerations
- (b) Missing Vouchers.
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 - (1) Freehold and Leasehold Property.
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 - (1) Agents' and Travellers' Commission.
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 - (7) Bills Payable.
 - (8) Bills Receivable Dishonoured
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3.—WAGES.

- (a) Internal Check as regards Wages.
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 - (3) The Preparation of Wages Sheets.
 - (4) Payment of Wages.
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4 —VOUCHING RECEIPTS.

- (a) General Considerations.
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 - (1) Income from Investments.
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5.—THE PASS BOOK.

- (a) Payments into Bank.
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6.—VERIFICATION OF CASH IN HAND AND AT BANK.

7.—PETTY CASH.

- (a) General Considerations.
- (b) Internal Check as regards Petty Cash.
- (c) The Auditor's duty in relation to Petty Cash.

CHAPTER II.

THE AUDIT OF CASH TRANSACTIONS.

✓ § 1.—Internal Check as regards Cash.

Before commencing the Audit of the Cash transactions of a business, it is most important that the Auditor should make himself familiar with the system of Internal Check in operation under this heading, since the majority of frauds arise directly in connection with cash. It is not intended to set out here any complete system of Internal Check as regards Cash, but merely to indicate the main points to which an Auditor should direct his attention.

The duties of the Cashier must be ascertained, particularly as to whether he has charge of any ledgers or books of prime entry other than the Cash Book. In large businesses, the Cashier will be fully employed with his proper duties, but in smaller concerns it is not usually found possible to occupy the whole of one man's time in the performance of the duties of a Cashier. In such cases the opportunities for the concealment of fraud by the Cashier are considerably enlarged.

✓ (a) Receipts.

The method of dealing with moneys received should be ascertained, and particular reference made to the following points :—

- / (1) Whose duty it is to open letters containing remittances.

- /(2) Whether all remittances are immediately crossed, by means of an indiarubber stamp, to the firm's Bankers, and marked "Not Negotiable."
- /(3) Whether the remittances are entered in a rough Cash Book or Diary, and checked and initialled by at least two persons, neither of whom is the Cashier; and whether the daily totals of such Diary are subsequently compared with the entries in the Cash Book, and if so, by whom.
- /(4) Whether printed counterfoil receipts are utilised, and if so, whose duty it is to make them out. This work should not be done by the Cashier, or by anyone connected with entering the remittances into the Diary. Unused counterfoil receipt books should be kept in safe custody.
- /(5) Whose duty it is to enter up the counterfoil of the paying-in book. The Cashier should enter up the slip to be retained by the Bank, while the clerk who makes out the counterfoil receipts should enter up the counterfoil portion of the paying-in book.
- /(6) Whether all receipts are banked daily, and whether or not the clerk, whose duty it is to take moneys to the Bank, is otherwise engaged in connection with the cash transactions.
- /(7) As to the method of recording and checking Cash Sales (if any).
- /(8) Whether there is any authority for Travellers to collect debts, and under what conditions.
- /(9) As to the frequency with which the Pass Book is checked with the Cash Book, and Reconciliation Statements prepared, and whether this is performed by anyone in addition to the Cashier.
- /(10) As to the custody and treatment of Bills Receivable.

(b) Payments.

The Auditor's attention should be directed to the following points :—

- / (1) Whether all payments are made by cheque, with the exception of those dealt with through Petty Cash; who has authority to sign cheques, and whether any counter-signature is required.
- / (2) Whether cheques are "Bearer" or "Order," and whether they are crossed "A/c Payee only—Not Negotiable" before being sent out.
- / (3) Whether proper regulations are in force for the checking of statements with invoices before the cheque is drawn, and comparison of the same with the account in the Bought Ledger.
- / (4) Whether vouchers are properly numbered and filed in order. This work should not be performed by the Cashier.
- / (5) What regulations are in force to sanction payments of a special nature. This authority should be exercised only by Principals or Directors.
- / (6) What system is in operation as regards Petty Cash.
- / (7) What system is in operation as regards the preparation and payment of wages.

§ 2.—Vouching Payments.**(a) General Considerations.**

The Auditor on commencing to vouch the Payments side of the Cash Book should ask for the Cash Vouchers, which should be in readiness for him, numbered and filed consecutively in order of entry in the Cash Book.

Where proper preparation is not made for the Auditor, it is common to find the vouchers entirely out of order, and unnumbered. This indicates a lack of organisation, and the Auditor is entitled to request that the vouchers be put in proper order before he commences to examine them, as otherwise he will find, if the payments are numerous, that a great deal of time will be required to find the voucher for each particular payment.

As soon as each voucher is passed, the Auditor should cancel it, preferably by the use of a rubber audit stamp; in order to prevent the same voucher being produced on a subsequent occasion. All subsidiary documents, such as invoices, statements, &c., relating to the voucher, should also be cancelled.

In examining the vouchers, the Auditor should pay attention to the following points:—

- / (1) The name of the party to whom the voucher is addressed.
 - / (2) The date of Invoice or Statement and signature to the receipt, and whether such receipt is on the authorized form of the payee, where such form is utilised.
 - / (3) Whether properly stamped.
 - / (4) Nature of payment.
 - / (5) Whether the payment has been passed as in order.
 - / (6) The account to which the item is posted.
- / It is important for the Auditor to observe the name of the party to whom the voucher is addressed. The fact of its being addressed directly to the business concerned is *prima facie* evidence that the payment relates to the business, but in some cases it may be

found that vouchers are addressed to an individual, such as a partner, director, or manager. When this is so, care must be taken to ascertain that the payment is a proper business one, and the Auditor should make certain of this by referring to the original invoice, to which the payment relates, and seeing that the goods are of such a kind as would be utilised by the business ; also it might be advisable to refer to the Goods Received book, to see that the goods have actually been received. If the item does not relate to goods, it is still more necessary for the Auditor to make sure that it is actually connected with the business, and he will do this by examining whatever evidence is available. The habit of addressing statements and vouchers to individuals instead of to the business is an unsatisfactory one, and requests should be made to the parties responsible for it, to avoid doing so in future. If, however, there are any items properly chargeable to individuals, the Auditor should ascertain that such payments are debited to the personal accounts concerned.

The date of the receipt should be noted to see that it corresponds with the actual entry in the Cash Book, and particularly the date of the year, as instances have occurred where an old account, relating to a previous year, has been utilised as a fictitious voucher for a fraudulent payment in the current year. The signature should be examined, and where a notice is printed on the statement that only the firm's printed receipts will be recognised, it should be seen that such printed form has been used. The use of printed forms, or of a rubber stamp containing the name of the firm to whom the payment has been made, is material collateral evidence of the genuineness of the

voucher. Where printed or stamped forms of receipt are not utilised, the signature should be examined, as such vouchers lend themselves more easily to manipulation. Where the amount of the sum received is not written, but entered in figures, such figures should be scrutinised, since the addition of a cipher might be very easily made. In all cases the figures of the receipt should be compared with the figures of the account.

3 Vouchers for amounts of £2 or over should bear a penny stamp, and the Auditor should see that the stamp is affixed where necessary. There are certain cases, however, where it is not usual to find stamps utilised, such as vouchers for Salaries, particularly where a Salary book is signed; and though this may not be strictly legal, it seems unnecessary for the Auditor to insist on stamps being utilised. Vouchers for payments made by one department to another, or for disbursements expended on behalf of the business, do not usually bear a stamp. Foreign vouchers will only bear the stamp of the country in which the receipt is signed, if such is legally necessary.

4 One of the principal objects of vouching, is to ascertain, not only that money has been actually paid away by the business, but that the payment has been made in respect of a transaction relative to the business, and that, as such, it is properly recorded. The nature of the payment, therefore, becomes a point of material importance. If the invoices relating to each statement are attached to the voucher, these should be cancelled by the Auditor, and checked on to the statement, and he will be able to ascertain the nature of the goods to which they relate. As far as the operation of vouching the cash is concerned, this

is the best method of filing invoices, but invoices are often filed separately, only the statements appearing on the file of vouchers. It is not then so easy to ascertain the nature of the payment, though the names of the parties, with whom the firm is accustomed to deal, will soon become familiar to the Auditor. In doubtful cases, the original invoices should be turned up, and examined, and, as previously mentioned, it may sometimes be advisable to proceed still further and check the actual receipt of the goods by examining the Goods Received book.

The Auditor will have ascertained whether there is an efficient system of Internal Check as regards the examination and checking of invoices and statements for payment, and he should also ascertain the names of the parties whose duty it is to perform this work, and to initial the documents as having been checked. In examining the vouchers, therefore, it should be seen that the items have been properly checked and initialled by the parties responsible, and particular care should be taken, where the payment is of a special nature, to see that it is duly authorized.

As each item is vouched, the Auditor should ascertain whether it is posted to a Personal or an Impersonal Account. If to a Personal Account, the transaction in respect of which the payment has been made, will have been originally recorded through some other book of prime entry, such as the Bought Journal, and will be subject to the Auditor's examination in connection with that book. Where, therefore, the original invoices are not filed with the vouchers, it is unnecessary to refer to them in connection with an item that is posted to a Personal Account. If, however, the item is posted to an Impersonal Account, the entry in the

Cash Book will, in all probability, be the original entry relating to the matter, and the payment must be fully substantiated by all the documentary evidence available, since the correct account in the Impersonal Ledger, to which the item should be posted, will be determined by the nature of such evidence. In order to avoid the possibility of an item being paid twice over, either in error or fraudulently, by means of being passed first through the Bought Journal (the cash payment in respect thereof being posted to the Creditor's Account), and also paid on an invoice, and posted direct to an Impersonal Account, the Auditor should not accept any receipted invoice as a voucher without exercising due caution.

The custom of certain business houses to issue their own forms of receipt when making payments, though it may have considerable advantages from the point of view of uniformity, is disadvantageous to the Auditor, inasmuch as it eliminates from the vouching the material evidence to be derived from a receipt on the printed account or form of the payee, and in such cases the Auditor should require documentary evidence, in the shape of statements or invoices, to be attached to the formal receipts. Similar remarks apply to the growing popularity of the system of utilising the endorsement on the back of a cheque as a form of receipt, accompanied, as a rule, by a notice that no other form of receipt is required. In such a case it will not be sufficient for the Auditor to examine the returned cheques only, as no evidence of the nature of the payment will be afforded in most cases by the endorsement, but he should also require production of additional evidence as above-mentioned.

Discount allowed by Trade Creditors is usually

entered in a special column on the credit side of the Cash Book reserved for Discount, the entry being made opposite the payment to which it relates.

The Auditor should see that Discount is taken advantage of wherever possible.

The Discount column should be cast, and the total checked to the credit of Discount Receivable Account in the Impersonal Ledger.

(b) Missing Vouchers.

As soon as the Auditor has completed his examination of the vouchers, he should extract a list of items which remain unvouched.

Vouchers for certain items will not be found in the ordinary voucher file, but the payments can be verified on reference to other books and documents. These will be dealt with subsequently, but there may remain a certain number of payments for which vouchers are altogether missing. It may be possible to accept the endorsed cheque as sufficient evidence of payment. This course may be adopted where there is collateral evidence available that the payment is in order, or where the payment is of a regular and certain amount, such as Salaries, or Directors' Fees, and where the signature of the payee is well known to the Auditor. It is not desirable, however, to rely upon endorsed cheques more than is absolutely necessary, and as a rule, where vouchers are missing, duplicates should be obtained. The idea that endorsed cheques can be taken as effective vouchers in the absence of other evidence is unsound.

Sometimes specific receipts are not available for payments on account, but these items can usually be vouched by reference to the final statement where credit is given therefor.

(c) Capital Expenditure.

The vouching of payments made on account of capital, and posted direct from the Cash Book to the Asset Account, is of great importance, since any erroneous treatment will directly affect the amount of profit or loss.

The subject of the distinction between Capital and Revenue expenditure demands separate treatment, and it is only proposed here to deal with the vouching of cash payments on capital account, and to indicate the procedure to be adopted in dealing with the usual classes of payments of this nature.

*(1) *Freehold and Leasehold Property.*

As a rule, there will be no actual receipt for the purchase price, though evidence may be available in the shape of letters from Solicitors, or others. The actual title deeds, and conveyance, or the lease, should be examined, and the purchase consideration ascertained. The Law Costs in connection with the acquisition of capital assets can be regarded as part of the cost thereof, and should be vouched by reference to the Solicitor's account.

(2) *Buildings.*

Where the Building is being erected under contract, the actual contract should be examined and accounts for extras, if any. Payments under the contract will usually be made on an Architect's certificate, and this should be seen by the Auditor, in addition to the actual receipt given by the Builder. The Architect's fees should be vouched by reference to his account; such items form part of the cost of building and can be charged to Capital. In certain cases the buildings may be

wholly or partially erected by the staff of the business, in which event allocation of materials and wages will be necessary. Such division will not, however, usually be made through the Cash Book, but will be dealt with through the Bought Journal and Journal respectively; and the vouching of such allocation will consequently arise in connection with those books. In some instances, however, cash purchases may be debited direct to the asset account, and the Auditor will then examine the invoices, in order to ascertain that the items are of a capital nature, and to see that they have been properly examined and passed by an authorized person.

✓ (3) *Plant and Machinery.*

Similar considerations apply here as in the case of Buildings, and all cash payments debited direct to the Plant Account will be examined in the same manner. Care must be taken to see that the expenditure is properly chargeable to capital.

(4) *Patents.*

The actual patent should be examined. In the case of a purchase the patent should also be seen, together with the assignment and the receipt for the purchase consideration. Patent Agents' fees in connection with the acquisition can be charged to capital, and will be vouched by production of the Agent's account. Fees for renewal of patents are often charged to the Patent Account, but this should not be done, as the item is of a revenue nature.

✓ (5) *Payments under Hire-Purchase, and Instalment Agreements.*

The actual Hire-Purchase agreement, or agreement to pay by instalments, should be examined, and the

vouchers seen for the payment of the instalments. As each instalment will include the proportion of interest which should be charged to revenue, care must be taken to see that the interest is not debited to the Asset Account, or, if this is done in the first instance, that it is afterwards transferred. In the case of wagons bought on the Hire-Purchase system, the amount of the interest is sometimes shown on the statements rendered by Wagon Companies. In other cases the rate of interest should be ascertained and adjustment made accordingly.

/(6) *Investments.*

For the purchase of Investments the Brokers' Bought Note and Receipt will be examined. The proper vouching of the item will also include the inspection of the securities; but this is not usually done in the course of vouching the Cash Book. It will be dealt with when the verification of assets is considered.

/(7) *Loans.*

The receipt from the borrower should be inspected if the Loan is without security. If on Mortgage, the Mortgage Deed will state the amount of the Loan, and should be examined, together with the Title Deeds. It should be seen that there is proper authority for the Loan.

/(8) *Office Furniture, Fixtures and Fittings.*

Similar considerations apply as in the case of Plant and Machinery, and all cash payments debited direct to the Furniture Account will be examined in the same manner.

Where the fixtures form Landlord's Fixtures, this fact should be considered in providing the necessary amount of Depreciation.

(d) Special Payments.

Certain payments found in most classes of businesses are subject to special considerations in vouching, and the more important of these are here noted. Special payments particularly relating to Companies will be dealt with in Chapter IX.

(1) *Agents' and Travellers' Commission.*

The agreement should be examined to ascertain the terms of the Commission and arrangements as to expenses. The Travellers' receipts for the commission paid should be seen, and the Commission Books examined and tested as to the manner in which the Commission is arrived at.

(2) *Travelling Expenses.*

Travellers' Expenses, when payable by the business, are frequently arranged on some fixed basis, and when this is the case it should be seen that such is not exceeded. In other cases the voucher for Travelling Expenses should specify the details of the expenditure, where the amount involved is of any consequence. Where no details are afforded, the Auditor should ascertain that the amount has been passed as in order by a responsible official.

(3) *Insurance Premiums.*

The Insurance Company's receipts will be in evidence for such payments. In the case of first premiums, where interim receipts have not been issued,

the Auditor will examine the Policies, which will contain a note of the premium paid.

(4) *Bank Charges.*

Bank charges for Commission, Cheque Books, Interest on Overdrafts and Loans, &c., should be vouched by inspection of the Pass Book, and where necessary the calculations should be checked.

(5) *Salaries.*

A Salary book should be in use, containing particulars of weekly and monthly Salaries. This should be cast by the Auditor, and cheques drawn for Salaries vouched therewith. If it is customary to obtain receipts, these should be examined. Any changes in the Salary list should be verified. Wages are dealt with separately in Section 3.

(6) *Petty Cash.*

Cheques drawn on account of Petty Cash should be vouched by ascertaining that they are properly entered on the Receipts side of the Petty Cash Book, care being taken to see that the dates correspond. The vouching of the Petty Cash Book itself is dealt with in Section 7.

(7) *Bills Payable.*

The returned Bill duly cancelled will be in evidence as a voucher.

(8) *Bills Receivable Dishonoured.*

If a Bill Receivable has been discounted through the Bank, but is dishonoured on presentation, the amount of the Bill will appear as a payment in the Pass Book, and will also be entered in the Cash Book, being posted therefrom to the debit of the person from whom the Bill was received.

Even where the Bill has not been discounted, it is common to find the amount thereof credited by the Bank on the date it becomes due, being subsequently debited if the Bill is dishonoured.

The Auditor should examine the dishonoured Bill, if it has not been since met or retired. The expenses of noting will appear in the Pass Book (in cases where the Bill has been presented through the Bank), and should be debited to the person from whom the Bill was received.

The expenses of discounting a Bill will be vouched with the Pass Book, if the Bill has been discounted with the Bank, and should be charged to the Discount Account. In vouching the charge for Discount it should be remembered that it is based on the nominal amount of the Bill, and not on the money advanced by the Bank. Thus the real Interest charged is at a higher rate than would appear from the Discount quotation.

/ (9) *Freight and Carriage.*

Freight and Carriage Accounts require careful examination. Where the accounts are voluminous payments are usually made on account throughout the month, and a final statement rendered. Such statement should be checked with the Carriage Accounts, and the payments on account vouched thereto, thus insuring that all such payments have been brought into account.

In Railway Accounts a rebate is often allowed for Cartage, where the rates charged include Cartage, but such Cartage is performed by the customer or his agent. The receipt given by the Railway Company will be for the full amount, and a contra receipt is given by the customer for the rebate. The Auditor should ascertain

whether such rebates have been allowed, and see that the actual cash payment made corresponds with the net amount payable. Rebates are also afforded by Shipping Companies in some cases.

(10) *Custom Duties.*

Where Custom Duties are paid by a Railway or Forwarding Agent on behalf of a customer, they will render monthly accounts, and issue receipts for payments on account, which should be examined by the Auditor. Where the transactions are numerous, such accounts will follow the same principle as the Freight Accounts above mentioned.

As the sums involved are sometimes very large, and special opportunities exist for fraud in connection therewith, the Auditor should vouch the Duty Account thoroughly.

Where Duty is paid direct in cash, receipts are not always issued, but an acknowledgment can be obtained from the Custom House on the occasion of each payment, if it is asked for. Where these have not been obtained the Auditor should request that they should be arranged for.

The Customs House authorities will not accept payment by cheque, but they will accept a transfer on the Bank of England. This is the usual mode for payment of large sums, and the Auditor will then see no voucher except the returned transfer, which is in effect a cheque payable to the Bank of England.

(11) *Partners' Drawings.*

It is not usual for specific vouchers to be available in respect of Partners' Drawings, but where the payment

is in the form of a cheque payable to the Partner concerned, the returned cheques should be obtained, and the partner's signature examined. Where payments are made to third persons on behalf of partners, it is not always possible to obtain the receipts, and such items should be vouched by direct reference to the partner concerned. Where Partners' Drawings are numerous, each partner should be asked to initial his Drawing Account as being correct.

Wages.

(a) Internal Check as regards Wages.

The vouching of wages is a very important part of the Auditor's duties in the case of a concern employing labour to any extent, since fraud has been found to arise more easily in this connection than in any other. It may be said that no Auditor can satisfactorily vouch this item unless there is a proper system in force as regards the preparation of the wages sheets and the payment of the men. The first care of the Auditor, therefore, will be to examine the methods adopted, and if he then finds that the Internal Check in this connection is inadequate, he should immediately advise his clients of the risks likely to result from the continuation of such a system, and suggest to them what alterations he considers to be advisable. Should his recommendations not be adopted, he will be wise to disclaim any responsibility for errors or fraud in this connection, in order to protect himself from any subsequent charge of negligence.

The best system to be adopted in any particular case will naturally vary with the circumstances, but

the principal dangers which any system should be designed to counteract are as follows:—

- (1) Inadequate time records, whereby men may be enabled to receive pay for time not devoted to the business, or for time wasted in the works.
- (2) Inadequate piece-work records, enabling pay to be received for work not executed.
- (3) Errors in the preparation of the wages sheets.
- (4) Fraudulent manipulation of the wages sheets, enabling moneys to be drawn in excess of amounts due, or false names to be inserted.

In order to counteract these dangers, a system should be in operation which will afford the best check possible, and necessitate collusion between two or more officials before any fraud can remain undetected for any length of time. It is essential that any such system should be strictly adhered to, and supervised by those responsible for the control of the business, who should at all times be prepared to introduce such variation as experience proves to be advisable.

The following is an outline of a system of preparing Wages Sheets and paying the Wages, which, if properly carried out, should effectually minimise the risk of fraud.

(1) *Time Records.*

The times of workpeople entering or leaving the works should be recorded, either by a gatekeeper or time-recording clock. In order to avoid loitering in the works, and to act as a check on the original record, the foreman of each department should take the times of the workpeople entering and leaving the shops, or time clocks should be utilised.

(2) *Piece-work Records.*

Where the pay is based on the actual work performed, and not on the time occupied, an efficient system of recording piece-work is essential. When the work is given out it should be entered on the piece-worker's card. On completion this card should be initialled by the piece-work viewer as soon as the work has been examined and checked by him, and where possible, also by the stock-keeper.

(3) *The Preparation of Wages Sheets.*

Separate Wages sheets or books should be utilised for Time-workers and Piece-workers respectively, and should be ruled to record all the essential particulars, special columns being provided for the gross amount payable, deductions for National Insurance contributions, fines or otherwise, payment on account, and the net amount payable. A column should also be provided shewing the Employer's contributions under the National Insurance Act, 1911.

The gate records and foreman's records as regards Time should be compared by two clerks in the Wages Office, and any discrepancies enquired into. Another clerk should enter upon the Wages sheets the names of the men employed, rates of pay, number of hours worked by each man daily, and particulars of any deductions. A separate clerk should work out and enter up the net amount due to each man, and cast the sheets, the calculations being checked by another clerk. Similar work should be performed in connection with the Piece-workers' wages. Each man responsible for the preparation of the sheets should initial for that portion of the work performed by him, and the whole

should be countersigned as correct by the Works Manager, a Partner, or a Director.

(4) Payment of Wages.

Wages should be paid by the Cashier, who should not perform any part of the work detailed above. He should prepare an analysis of the Wage Payments, so that the proper amount of change can be obtained from the Bank. A separate cheque should then be drawn for the precise amount of the wages, and each man's wages placed in a tin, or sealed up in a small bag numbered with his particular number. The men should attend personally to receive their wages, which should be paid by the Cashier, the foreman of each department being present when the men in his shop are being paid, in order to avoid the possibility of substitution. Special arrangements should be made for the payment of wages of men who are absent, and the wages of one workman should not be paid on his behalf to another.

As a general rule it is not found possible to obtain the signature of each man for his wages, and where such a system as the above is in force, it is not necessary to do so. The payment should be attested by the signatures of the Cashier and the Foreman, and of the Works Manager, if present.

(b) The Auditor's Duty as regards Wages.

The Auditor will ascertain the precise particulars of the methods employed in preparing and paying wages, and will pay special attention to any portion of the system which he considers to be weak. Where such a system as the one described above is in force, the Auditor will ascertain that it is regularly and

properly carried out, and that the signatures and initials of those responsible are duly appended to the Wages sheets. He will vouch the cheque drawn for Wages with the total shown by the sheets, and check the casts and extensions of a certain proportion. Sometimes it is arranged for the Auditor to attend personally without notice at the time of payment of wages, though this cannot be considered part of his duties in the ordinary course.

§ 4.—Vouching Receipts.

(a) General Considerations.

From the Auditor's point of view the operation of vouching receipts is more difficult than that of vouching payments, since only indirect evidence can as a rule be obtained.

The system of Internal Check should be carefully enquired into by the Auditor, and he should direct special attention to any part that he considers inadequate. In order to ascertain that the system is properly carried out, he should test each portion of the check in operation, and if discrepancies are found he should carry his examination further. If, on the other hand, the transactions he has examined are in order, he is entitled to assume that the remainder can be safely passed. Where a rough Cash Book or Cash Diary is kept, such books should be exhaustively tested with the Cash Book proper, since if amounts received are entered in the former but appropriated by the Cashier, and not entered in the Cash Book, the Auditor might be held responsible if he failed to detect the fraud, owing to his omission to compare the two books. This point is one of some importance, as it

raises the question as to how far it is the duty of the Auditor to go behind the financial books of the business, and to examine the memoranda books, if such exist, on which the entries in the financial books are based. It is probable that where such memoranda books are part of the recognised system in force in the business, an Auditor would be held negligent if he failed to examine them, but where they are not part of the recognised system, the question is open to considerable doubt.

This point emphasises the desirability of the Auditor obtaining a list of the books in use, since, if such memoranda books are not included, he could not reasonably be held to be cognisant of their existence as part of the financial system.

(b) Credit Sales.

Apart from checking the Sales Ledgers, the Auditor cannot specifically verify receipts on account of Credit Sales, particularly where it is not the custom of the business to issue printed counterfoil receipts to their customers. Where counterfoil receipts are in use, the Auditor should ascertain the regulations in force regarding them, and vouch a certain number of the counterfoils with the Cash Book.

It cannot be contended that in a large business it is the duty of the Auditor to check the whole of the counterfoil receipts, since, in itself, this operation will not necessarily discover any frauds that may have taken place. There is nothing to prevent the amount of the receipt being entered on the counterfoil as less than the sum actually received. Further, unless unused counterfoil receipt books are kept in safe custody, there is nothing to prevent receipts

being issued from unused books. On the other hand, if the counterfoil is properly filled in, but the entry in the Cash Book is incorrect, and the Auditor fails to discover the fraud by omitting to check the counterfoil receipts, he might find himself in a position of some difficulty. All spoilt receipts should be attached to the counterfoil, and cancelled by the Auditor, as far as his examination extends. It should be seen that the dates on the counterfoils correspond with those in the Cash Book.

Where Travellers are authorized to collect moneys from customers, the regulations in force should be ascertained, and it should be seen that they are sound and regularly adhered to. If the Travellers issue counterfoil receipts, the counterfoils should be tested. The Travellers' Returns, giving particulars of the amounts received, should also be examined and compared with the actual receipts in the Cash Book.

Discount allowed to debtors is usually entered in a special column on the debit side of the Cash Book reserved for Discount, the entry being made opposite the receipt to which it relates. The Auditor should ascertain the terms on which discount is allowed, and test a certain number of the entries to ascertain whether the discount is in order. This is important, as defalcations in respect of receipts have been concealed by means of fictitious entries of discount. The Discount columns should be cast, and the total checked to the debit of the Discount Payable Account in the Impersonal Ledger.

(c) Cash Sales.

The opportunities for fraud in this connection are very numerous, and no amount of checking by the

Auditor will be of much avail unless an efficient system of Internal Check is in operation.

Assuming a proper system to be in force, the Auditor will exhaustively test its operation by checking the counterfoils of the Cash Sales Books on to the Salesmen's Summaries or Extracts. Each Salesman's Extract should agree with the analysis of the cash received by the Receiving Cashier, the details of which can again be checked with the Cash Sales Counterfoils. The daily totals of the Receiving Cashiers' Cash Books should be vouched into the General Cash Book.

(d) **Special Receipts.**

Certain receipts of common occurrence are subject to special considerations in vouching, and the more important of these are here noted. Special Receipts particularly relating to Companies will be dealt with in Chapter IX.

(1) *Income from Investments.*

A separate Ledger Account should be utilised for each Investment, and where a large number of Investments are held, an Investment Ledger will usually be found. At the head of each Account the full title of the Investment should be stated, together with a note of the dates on which Interest or Dividends fall due. The Auditor should ascertain that all Dividends and Interest that should have been received have been received at the proper dates. Where the rate is fixed, the amount of the Dividend or Interest can be verified by checking the calculation on the nominal value of the stock held. In other cases, the counterfoils of the Dividend Warrants should be seen. Where

Investments are sold ex div., it should be seen that the dividends are subsequently received, and similarly when bought cum div.

(2) *Rents Receivable.*

In order to vouch the income derived from this source, the Auditor should inspect counterparts of Leases and Agreements, noting the rent payable, and the provisions as to repairs and allowances. He should then ascertain that all Rents that should have been received have been received, and vouch deductions made by the tenants. Enquiry should be made into arrears outstanding for any length of time, in order to ascertain whether they are genuine. Similar precautions must be taken in respect of properties which are shown as unlet. Where counterfoil Rent Receipt Books are utilised, the Counterfoils should be checked. When rents are collected by Agents their accounts should be examined and vouched.

(3) *Interest on Loans and Bank Deposits.*

If the Loan is secured by Mortgage Deed, the latter will be consulted for the rate of interest and dates when payable. If the Loan is unsecured, whatever other evidence is available will be inspected, and it should be seen that the interest is duly received. Interest on Deposit will be verified by reference to the Bank Pass Book, and the correctness of the amount there credited can be tested by checking the calculations in accordance with the terms allowed by the Bank. Where the deposit is a fixed yearly one. Income Tax will be deducted by the Bank in crediting interest, otherwise interest should be credited gross.

(4) *Bad Debt Dividends.*

These items should be vouched by examining the counterfoils of the dividend warrants or other documents which will state the amount of the debt and the rate of the dividend.

(5) *Sale of Investments.*

The amount received should be vouched by reference to the Brokers' Sold Note. Where the Investments have been sold cum div., it should be seen that the proceeds of sale are apportioned as between Capital and Income.

(6) *Bills Receivable.*

The Bills Receivable Book will be examined to ascertain the due dates of the various bills. The proceeds of those discounted will be received prior to maturity, and should be vouched by reference to the Bill Book, or Bills Discounted Book, and the rate of discount charged. Those held till maturity should be received in full on the due date. If not so received, they will either have been retired and a new bill given, or dishonoured.

(7) *Miscellaneous Receipts.*

Other Special Receipts, such as Receipts from the Sale of Fixed Assets, Receipts from Insurance Companies in respect of Claims, &c., will be vouched by reference to the correspondence, and any documents relating to the matter.

§ 5.—The Pass Book.**(a) Payments into Bank.**

The desirability of paying all receipts into the Bank daily has already been indicated, and where this regulation is in force, and a separate Bank column provided on the Receipts side of the Cash Book, the Auditor should check the amounts paid in as shown by the Pass Book with the entries in such column. Note should be taken of the dates, to see that they correspond. The majority of London Banks do not give credit for country cheques on the day on which they are paid in, and consequently, a few days will elapse between the date of the entry in the Cash Book, and the date at which the Bank gives credit therefor. It should be seen that such period is not unreasonable. The comparison of dates is important, since cases have been known where the Cashier has continuously delayed the payment in of moneys for a few days, thus being in a position to manipulate regularly the current receipts.

Where no separate column is provided for Bank transactions, the agreement of the receipts side of the Pass Book with the Cash Book may occasion considerable difficulty, and the Auditor may be obliged to have recourse to the counterfoil Paying-in Book, in order to ascertain how the items credited by the Bank are made up. He will also examine this book in other cases where disagreement exists between the Cash Book and the Pass Book, and he should particularly refer to it for the purpose of vouching moneys received and paid into the Bank prior to the date of closing the accounts, but not credited by the Bank till the next period. As the Paying-in Book will show the actual date on which the items were paid in, and

will be initialled by the Receiving Clerk, the record will be sufficient evidence that the moneys were paid in prior to the date of closing the Accounts, if supplemented by an examination of the Pass Book for the subsequent period, to see that the moneys have been actually credited in due course. In certain businesses it is the custom to enter moneys received after the close of the balancing period, as if they had been received and paid into the Bank on the last day of the period, in order that these transactions may be recorded in the books before the close of the period, and so reduce the outstanding balances. Such treatment cannot be regarded as in order, since it will have the effect of increasing the Cash appearing in the Balance Sheet, and decreasing the outstanding debtors correspondingly. In this way the accuracy of the Balance Sheet is affected, but this can be remedied by decreasing the Cash to the extent of the items in question, and increasing the debtors correspondingly. As, however, the Trial Balance of the books will include these items as having been received, the Auditor must vouch the receipt thereof as if they had actually been received during the period.

The vouching of the totals paid into the Bank with the entries in the Bank column will not, of itself, prove the correctness of those totals, and this should be done by casting the detail columns.

(b) Payments out of Bank.

Where the Pass Book has not already been agreed with the Cash Book, it will be necessary for the Auditor to check the payments in detail with the Bank Pass Book, and he should be careful to observe that all Bank Charges, Dishonoured Bills, Returned Cheques, &c., have been properly recorded in the Cash Book.

Where, however, the payments are numerous, and a Reconciliation Statement has been prepared and presented to the Auditor, it may not be necessary for him to check the payments with the Pass Book in detail, assuming those payments to have been vouched and the credit side of the Cash Book to have been cast. If a separate column has been provided for Bank transactions, it will be possible for the Auditor to prove the Payments side in total with the Pass Book. In order to agree the total payments appearing in the Cash Book with those shown in the Pass Book, it will be necessary to add to the Cash Book total, cheques outstanding at the commencement of the period, and to deduct therefrom cheques outstanding at the close of the period. Adjustments will also have to be made if the dates of balancing the Pass Book and Cash Book do not correspond. If the Receipts side of the Cash Book has already been checked with the Pass Book, any contras appearing in the Pass Book, omitted from the Cash Book, will be apparent, since these items, as far as the debit entries are concerned, will not have been checked with the Cash Book. Such contras arise from time to time, and the origin thereof must be ascertained. They are occasionally due to errors on the part of the Bank, rectified by contra entry, or more often to cheques paid in and returned on account of irregular endorsement, &c. The latter are not usually put through the Cash Book as returned, and the contra entry in relation to them will therefore not appear in that book. After adjusting such contras (if any), it should be possible for the Auditor to agree the totals of the Payments side of the Cash Book and Pass Book respectively.

Cheques drawn before the close of the period, and appearing as payments in the Cash Book, but debited in the Pass Book in the succeeding period, should be checked through into that period by the Auditor as far as possible. Where the method of treating as receipts items received in the succeeding period is adopted, as referred to above, it will usually be found that the same principle is applied as regards payments, with the result that the Cash balance is reduced, and the Creditors decreased correspondingly. In this case a similar adjustment should be made to that described as regards receipts, in order that the Balance Sheet may be correct. For the purpose of reconciling the Cash Book balance with the Pass Book balance, however, such items must be regarded as outstanding cheques.

(c) Reconciliation with Cash Book.

A Reconciliation Statement should be prepared and submitted to the Auditor, showing how the Cash Book and Pass Book balances are agreed, and the Auditor should check the details thereof with the Pass Book. If no such statement is submitted, he will be obliged to prepare one himself, which he will do by taking the balance as shown by the Pass Book, adding thereto cheques paid in but not yet credited by the Bank, and deducting therefrom outstanding cheques drawn but not yet presented for payment.

In large concerns separate Cash Books are often utilised for Cash In and Cash Out respectively. If this is so, the Auditor should check the totals to the Cash Book in which the balancing is effected, or to a Total Cash Account in the Impersonal or Private Ledger,

which is sometimes employed in order to prevent the clerks from knowing the bank balance.

Difficulty is frequently experienced where there are a large number of cheques drawn for a similar amount, some of which are outstanding, and, in such cases, care should be taken to ascertain that those treated as outstanding according to the Cash Book are the actual cheques which were outstanding. Accuracy in this direction can be most conveniently assured by comparing the date stamped on the returned cheque with the date of the entry in the Pass Book, and this can be very quickly done where the numbers of the cheques are inserted both in the Cash Book and in the Pass Book.

The Reconciliation of the Pass Book with the Cash Book, where there is an Overdraft, follows on the same lines, but the cheques not credited will be deducted from the Overdraft, and the cheques not cleared added thereto.

Where a Reconciliation Statement is prepared without the whole of the entries in the Pass Book and Cash Book being checked, it often happens that Bank Charges have been omitted, and consequently, the Reconciliation Statement disagrees to that extent. This particularly arises where it is the custom of the Bank to credit Scotch and Irish cheques less the Commission charged, rather than crediting the full amount of the cheque and charging the Commission on the other side.

Similar considerations apply when Bills Receivable have been discounted, and the Bank has credited the amount advanced on the Bill in place of crediting the full amount of the Bill, and charging the Discount on the other side.

§ 6.—Verification of Cash in Hand and at Bank.

Where all receipts are not banked, and all payments are not made by cheque, the balance appearing on the Cash Book will be composed of Cash in hand and at the Bank, and will be divided accordingly, if separate columns have been utilised for Cash and Bank transactions, as should always be done.

In such an event, it is sometimes arranged that the Cash balance in hand at the close of the period should be paid into the Bank on that day, and where this is done, the Auditor will be able to vouch the asset through the Pass Book. Where this procedure is not adopted the Auditor should, if possible, attend on the day of closing the accounts, and verify the balance in hand by actual inspection. This, however, is not usually convenient, and the Auditor must then check the Cash Book up to the date of his attendance, and verify the existence of the balance in hand as at that date.

The inspection of the Pass Book is not sufficient evidence for the verification of the Bank balance, since cases have been known where a fictitious Pass Book has been presented to the Auditor, containing an apparently correct balance, when, as a matter of fact, the real Pass Book, not produced, showed a very much smaller amount. In one case, very large frauds remained undiscovered by the Auditor because he omitted to call for further evidence of the balance. It is therefore essential that the balance as shown in the Pass Book should be verified, either by a certificate from the Bank, or by actual inspection of the Banker's Ledger. It is more usual for the former method to be adopted, and it is advisable that this certificate should be sent direct to the Auditor.

Cash on deposit should be verified in a similar manner, and if deposit receipts have been issued these should be examined.

§ 7.—Petty Cash.

(a) General Considerations.

The treatment of Petty Cash payments is often regarded as an unimportant matter, and it is common to find in the case of businesses which have not been subject to Audit, that the Petty Cash arrangements are very inadequate, and afford numerous opportunities for manipulation. Under these circumstances it is not unusual to find that fraud has taken place, and it is therefore essential for the Auditor to direct his attention to this subject, and recommend the adoption of a proper system. This is the more important as vouchers cannot be obtained for a large number of Petty Cash payments. Moreover, in most businesses of any size, the number of payments, though small in individual amount, are very numerous, and it will not be possible for the Auditor to satisfy himself, by the usual method of vouching, that all the payments are in order.

Cheques drawn for Petty Cash are often posted to a Petty Cash Account in the Impersonal Ledger, and the details of the Petty Cash itself recorded in a small rough Cash Book. In such cases the Auditor will usually find on enquiry that there are no vouchers worth speaking of to support the payments, and the book is not subject to the examination of anyone other than the Petty Cashier. The expenditure made

will probably not be analysed, but the total, debited to the Petty Cash Account in the Impersonal Ledger, will be written off to Profit and Loss.

Such a system should be disapproved of by the Auditor, and he should recommend the adoption of a columnar Petty Cash Book, containing on the debit side a column for receipts, and on the credit a column for total payments, with subsidiary columns for the various classes of expenditure usually incurred. Each item of expenditure should be extended into its appropriate column, and the book balanced at least once a month. A column should be provided for the voucher number, and the vouchers numbered and filed in order. It is advisable to provide an additional column, into which to extend items for which there is no specific subsidiary column. A folio column will be provided, and each item posted to the debit of the Account to which it relates.

There are two methods of regulating payments to the Petty Cashier, the first being to draw cheques as and when required for Petty Cash purposes, the same being entered in the Receipts column of the Petty Cash Book.

The second method is known as the *Imprest System*, under which the Petty Cashier receives a starting sum, the amount of which will vary with the demand on the Petty Cash. When the balance requires replenishing, a cheque is drawn for the precise amount of the Petty Cash payments, thus placing the Petty Cashier in possession of his original balance. This system has certain advantages in some cases, since it necessitates the Petty Cash Book being kept regularly written up, as the Petty Cashier should be required to furnish an

analysis of the payments made each time that he requires a further cheque. It is particularly applicable where the Petty Cash relates to a branch, or when it is inconvenient to draw Petty Cash cheques at short notice. In other cases it might be disadvantageous, since it might result in placing a larger balance in the hands of the Petty Cashier at the commencement of each period than is necessary. On the other hand, the Imprest System is convenient for checking purposes, since at any moment the cash in the hands of the Petty Cashier, plus any vouchers for payments made since his balance was last replenished, should be equivalent to his original opening balance.

/(b) Internal Check as regards Petty Cash.

It has been pointed out that it is not usually possible for the Auditor to verify the petty cash transactions in detail, and therefore it is advisable that, in addition to a good system of account, there should exist an efficient internal check, by means of which the Petty Cash can be kept effectively under control.

The points to which such a system should be applied are as follows :—

- (1) The Petty Cashier should be a responsible official, and should not himself be the Cashier.
- (2) The only receipts paid into Petty Cash should be cheques drawn for that purpose. Small receipts are frequently entered in the Petty Cash, but this is inadvisable, and the rule should be enforced that all receipts, however small, should pass through the Cashier's hands, and be paid into the Bank.

- (3) No payments should be made unless a proper voucher is obtained. Many payments are, however, of such a nature that no receipt is available, and to enable a proper record thereof to be obtained, petty cash slips or dockets should be provided, and the person making the payment should be required to insert the necessary particulars, and initial for the sum received, the docket being counter-initialled by a responsible official where necessary. In this way either an actual receipt or a docket will be in evidence for each payment.
- (4) At frequent intervals the Petty Cash Book should be thoroughly checked in detail with the vouchers, and the balance in hand verified by some responsible official, who should initial the Petty Cash Book accordingly.
- (5) No clerk should be allowed to borrow Petty Cash from the Petty Cashier under any circumstances.

(c) **The Auditor's Duty in relation to Petty Cash.**

Where a good system of Petty Cash is in force, supported by an efficient Internal Check, the Auditor will not, as a rule, find it necessary to perform much detail. He should ascertain that the system is regularly carried out, vouch the cheques drawn for Petty Cash from the credit side of the Cash Book to the debit side of the Petty Cash Book, and cast the Receipts and Total Payments columns of the latter. The totals of the subsidiary columns should be cross-cast, and agreed with the Total Payments.

The vouchers should be tested exhaustively, either by taking a certain consecutive period, or by examining all vouchers over a certain amount. If, in the course of this investigation, irregularities are brought to light, the Auditor should pursue his examination further.

Occasional attention should be directed to the Postage Book, and the amounts paid out of Petty Cash for Postage vouched into such book. It should be seen that the Postage Book has been regularly checked, and it may be advisable to count the balance of stamps in hand where the same is considerable. The main point, however, is for the Auditor to see that a proper system of check on the Postage is in force, since otherwise the opportunities to commit fraud may prove too tempting to be resisted. Frauds in connection with Postage, although they may individually relate to small amounts, are sometimes consistently practised for a long period, and may in this way ultimately involve a considerable sum. In small points of this nature business men are frequently negligent, and when the Auditor draws attention to the weakness of the system employed, are sometimes apt to dismiss the subject as too small for notice. It cannot, however, be too strongly emphasised that it is the duty of all employers to safeguard their employes against temptation to commit fraud, by utilising proper systems of check; and frauds on Postage or Petty Cash, though they may involve comparatively small amounts, have as great an effect in undermining the character of the person concerned as those of a larger nature. It should be remembered also that the persons employed to conduct these transactions are usually not in very remunerative positions, and

consequently the attraction of a few shillings a week may prove of material moment to them.

Where the Petty Cash Book is kept on the columnar principle, it may be made to form part of the double entry, and, in that event, there will be no Petty Cash Account in the Impersonal Ledger, and the balance of the Petty Cash Book will form part of the Trial Balance. The totals of the columns will, in such a case, be posted direct from the Petty Cash Book to the Impersonal Ledger, and should be checked by the Auditor. Otherwise a Petty Cash Account will be opened in the Impersonal Ledger, which will be debited with all cheques drawn for Petty Cash, and credited with the analysis of the various payments, either through the Journal, or by way of direct transfer to the Ledger Accounts involved. The Auditor should vouch such transfers with the analysis of the Petty Cash, and see that the balance brought down on the Petty Cash Account in the Impersonal Ledger agrees with the balance as shown on the Petty Cash Book.

Where the Petty Cash system is not a good one, and where there is no effective internal check, the Auditor should examine the transactions carefully, and vouch them as far as possible. Where the evidence of payment is not sufficient, he must report to his clients the facts of the case, and inform them that he cannot hold himself responsible for the accuracy of Petty Cash transactions, owing to the lack of available evidence.

In any event, the Auditor should verify by actual inspection the balance in hand. Where he cannot attend on the day of the Balance Sheet, he should vouch the Petty Cash Book up to date, and call upon the Petty Cashier to produce his balance. It will fre-

quently be found that such balance consists in part of IOU's. Due note should be taken of these by the Auditor, and he should report the matter to his clients.

Where two or more Petty Cash Accounts exist, the balances should be verified simultaneously in order to avoid substitution of one balance for another.

In the case of the *London Oil Storage Co., Ltd. v. Sear, Hasluck & Co.* (Acct. L.R. 31, p. 1), it was found that the Auditors had committed a breach of duty in not vouching the existence of the Petty Cash balance, which was shown by the books to be £796, but was in fact only £30.

SYNOPSIS OF CHAPTER III.

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CHAPTER III.

THE AUDIT OF TRADING TRANSACTIONS.

§ 1.—Purchases.

(a) Internal Check as regards Purchases.

It is highly important that a proper system should be in force for the purpose of checking the receipt of goods and the accuracy of invoices, in order to prevent fraud and errors, and to ensure that the business only pays for the goods which it actually receives.

Before entering on an examination of the Purchases, the Auditor should ascertain what system, if any, is in force, and the following are the principal points to which his attention should be directed:—

- (1) What officials are authorized to sanction the ordering of goods?
- (2) Whether a Goods Inwards Book is kept by the Gate Office Foreman, in which particulars of all goods received are entered.
- (3) Whether the invoices, when received, are checked by the Invoice Clerk with the Order Book, and the number of the order entered upon them. The invoices should also be checked with the Goods Inwards Book, to ascertain whether the goods have been actually received, and a reference made both in the Goods Inwards Book and on the invoices. This should prevent the entering of fictitious invoices or the treatment of duplicates as originals. The Invoice Clerk should

initial the invoice, to indicate that he has checked the calculations and verified the item as above described.

- (4) Whether each invoice is then passed to the particular department from which the goods were ordered, the manager of which should initial the same, thus making himself responsible for the correctness of the price and quality of the goods.

(b) The Bought Journal.

There are various forms of Bought Journals utilised, but the columnar system is now very generally adopted, under which separate columns are provided for each class of expenditure or for Departmental purposes. Such a book should contain columns for the number of the invoice, the date, the name of creditor, and particulars, Bought Ledger folio, total column, and subsidiary columns, headed according to the nature of the business and to the subdivision required. It may be found convenient to provide a further column, entitled a ledger column, in which can be inserted all those items for which no subsidiary column is provided, the same being posted separately to the particular ledger accounts to which they refer.

Each invoice will be entered as received, and numbered consecutively. Where the invoices are filed in the order of the Bought Journal, it is not usual to find particulars of each invoice copied in that book, but where the invoices are filed with the cash vouchers, as mentioned in the previous chapter, it is not so easy to refer to them, and consequently it may be found advisable to copy the particulars into the Bought Journal. The totals of this book should be posted

monthly, and the Auditor should check the casts, and cross-cast the totals of the subsidiary columns to see that they agree with the grand total. The postings of the totals of the subsidiary columns will be checked to the accounts in the Impersonal Ledger to which they relate.

Where no columnar form is utilised, but the Bought Journal is in the form of an ordinary Journal, it will probably be necessary for the items to be analysed monthly, or at other intervals, according to the various Nominal Accounts to which they relate, and the Auditor should see that this is correctly done. The columnar system, however, has such considerable advantages over the older form, that its adoption should be recommended by the Auditor, if it can be usefully applied.

In some cases the number of columns requisite is too large to enable them to be conveniently dealt with in one book, and the Bought Journal should then be divided into two or more sections. In such cases it is usual to find a Charges Journal in operation, recording all invoices relating to expenses other than purchases of goods.

(c) Vouching Invoices.

The Auditor should see that the invoices are initialled by the Clerk whose business it is to check the same as above described. Each invoice relating to goods should bear a reference to the Gate Book or Goods Inwards Book, and the Auditor should occasionally refer to this book to see that the goods stated in the invoice have actually been received. Care should be taken to see that the invoices are made out in the name of the firm, and appear to be of a nature

relating to the business carried on. It should be seen that each item is extended into its proper subsidiary column, and if any column is provided for capital expenditure, such as plant and machinery, the items contained therein should be checked, and it should be ascertained that they are strictly of a capital nature. All such items should be passed and initialled by some superior official.

At the close of the balancing period it is important for the Auditor to ascertain, as far as possible, whether all goods received prior to the date of closing the books are included in the purchases, since, if they are included in the stock but omitted from the purchases, the profit will be affected to that extent. A common method of inflating the profits is to manipulate the purchases in this manner, and where no proper system is in force, dealing with the receipt of goods, it may be difficult for the Auditor to detect fraud or errors of this nature.

Where, however, the Goods Inwards Book is duly referenced to the invoices and Bought Journal, it can be ascertained whether those goods received prior to the date of closing the accounts are brought into the Bought Journal before that date or not. If they are entered in the succeeding period the Auditor must ascertain whether they have been included in the stock, and whether they were actually received before the date of closing the accounts or not. If so received they should be included in the stock and in the purchases.

Errors sometimes arise in this connection owing to the system prevalent in certain trades of post-dating invoices. This system is adopted for the pur-

pose of giving a fictitious credit, all goods ordered, say, after the 20th of each month being post-dated to the 1st of the following month, in order to extend the term of the two or three months' credit that may be allowed. For the convenience of the ledger keeper, it is usual to make the entries relating to these invoices as at the 1st of the month, although the goods themselves have been received in the previous month; and care must be taken at balancing periods to ascertain that all goods of this nature brought into stock have been properly dealt with as purchases, or an adjusting entry made to deal with them.

It is customary in many businesses to allow Trade Discount. This discount is an allowance made by one house to another in the same trade, and takes the form of a fixed percentage of the catalogued or fixed price of each article. It varies greatly in different trades, and even on different articles in the same trade, and bears no relation to the payment of cash. The deduction is made from the invoice at the time of rendering the same, and in vouching the invoices the Auditor should see that only the net figure is entered in the Bought Journal, as Trade Discount should never, under any circumstances, appear in the Ledger.

Cash Discount, on the other hand, is an allowance made by the seller to the purchaser in consideration of the latter paying his account at once, or within the period of credit allowed. Such discount, as affecting purchases, is usually recorded in a Discount column on the credit side of the Cash Book, the discount being entered therein, and posted to the debit of the account in the Bought Ledger. Where such discount is regularly taken advantage of, it is sometimes deducted

from the invoice before the entry is made in the Bought Journal. Such treatment cannot be recommended, inasmuch as the ledger account with the creditor will not be found to agree with the statement rendered by the latter, and, moreover, the Discount Account will not record the Bought Discounts that have been taken advantage of. The argument utilised in favour of this system is that it prevents the deduction of the discount being overlooked, but where there is a proper method in force relating to passing statements for payment, this difficulty should not arise.

§ 2.—Purchase Returns. ✓

The Auditor should ascertain that a proper system is in force with regard to the treatment of purchase returns, so as to ensure that full credit is obtained for all goods returned. The Departmental Manager concerned should send an Advice Note relating to the item to the Counting House, which should be checked by the Invoice Clerk with the original invoice, the proper entry being made in the Bought Returns Book. If the invoice has not already been paid, the Advice Note will be attached thereto in order that it may not be overlooked when payment is made. If the original invoice has been paid, a Credit Note should be obtained from the creditor, and placed with the invoices not yet paid, so that it can be seen that the proper deduction is made from the next payment.

• The form of the Bought Returns Book may be of a columnar nature, and similar to that of the Bought Journal. If this is not convenient, the Bought

Returns Book must be analysed, and the Auditor, after checking the casts of the book, will check the postings of the totals to the Nominal Ledger.

§ 3.—Sales.

(a) Credit Sales.

The Auditor should ascertain the system in force relating to the record of sales from the time that the order is received until the entry is made in the Day Book. The system adopted will naturally vary with each class of business, but there should be a proper record of all goods sent out, which can be examined with the Order Book, and the prices and extensions should be checked. Much saving of labour is afforded by the utilisation of a system whereby three copies of each invoice are obtained, the first being sent to the customer, the second being utilised as a delivery note, while the third remains in the book, which is used as the Sales Day Book.

Where the nature of the Audit requires the whole of the detail to be checked, the Sales Day Books should be cast, and the carry forwards checked, the monthly or other totals of these books being checked to the Sales Account in the Impersonal Ledger. Where, however, the number of transactions involved is considerable, and the system of Internal Check in connection with the Sold Ledgers, as dealt with hereafter, is satisfactory, it will be sufficient if the Auditor exhaustively tests the casts in the Sales Day Books. In any event, it is advisable that, he should check all the carry forwards, as this in itself will afford a very good test.

Occasionally sales will be made of old Plant and Machinery, or other assets of a capital nature, the entries being put through the Sales Day Book. Where this is done, care should be taken to see that the total of the Sales is correctly analysed, and the amount derived from the sale of capital assets duly credited to the asset accounts in question, since, otherwise, revenue will receive an improper credit.

Where there is reason to suppose that the Sales are not bonâ fide, and that entries have been created for the purpose of inflating the profits, the genuineness of the Sales can be tested by reference to the Order Book, and to any correspondence that may be in evidence relating to particular orders. The Goods Outwards Book should also be examined, to ascertain that the goods in question have actually left the premises. This test is particularly useful towards the close of the balancing period, in order to discover whether Sales really belonging to the succeeding period have been treated as actual Sales at the date of closing the accounts, although the goods themselves may not have been despatched, and may have been included in Stock, thus creating a fictitious profit.

(b) Cash Sales.

It has already been pointed out that it is essential there should be an efficient method of recording transactions of this nature. Where the book-keeping system is indifferent, it will frequently be found that the Cash Sales are merely entered as cash is received, and that there is no method by which the Auditor can verify their accuracy. In such cases he should disclaim any responsibility in connection with the item, and suggest that a proper system be utilised.

The vouching of Cash Sales, where an efficient system is in force, has already been dealt with in Chapter II., § 4 (c).

(c) Goods on Sale or Return.

Where Goods have been sent to customers on Sale or Return, the Auditor should ascertain that Goods in the hands of customers unsold at the date of the Balance Sheet are not treated as Sales, but are brought into account as Stock in the hands of customers, at cost price, a percentage being deducted where necessary for damage. It is a primary rule that no credit should be taken in respect of profit on sale until the sale is actually effected. If, therefore, the sale is not completed at the date of the Balance Sheet, no profit in respect of the transaction should be taken credit for.

The proper record of transactions of this nature demands the utilisation of a separate Sale or Return Journal, which should be provided with columns recording the selling price of the goods sent out, value of goods returned, and value of goods sold. In such a case only the column recording the actual sales should be posted to the debit of the customers' accounts in the Sold Ledger, the other columns not forming part of the double entry. The difference between the total of the Goods Sent Out column, and the totals of the Returns and Sales columns taken together, will represent the amount of the goods in the hands of customers at any date at selling price, which, after being reduced to cost, as above-mentioned, should be brought into the Trading Account and Balance Sheet as stock.

Where the number of transactions is numerous and the articles of considerable value, it may be advisable to utilise an entirely separate set of books on a Double Entry basis. Under this system a Sale or Return Ledger will be in operation, the balances on which will represent the goods out with customers at selling price. Such balances, however, must not be brought into the Balance Sheet as debtors, but the goods, represented by such balances, must be taken to the credit of the Trading Account at cost or under, and appear on the Balance Sheet as stock in the hands of customers.

It may be found that transactions of this nature are not properly recorded, but are passed through the ordinary Sales Day Books, the goods being debited to the customers' accounts in the Sales Ledger, corresponding credit being given if the goods are returned. In such a case the debtors' balances will include goods in the hands of customers at selling price, and the sales will have been correspondingly increased. The Auditor should require a schedule of goods in the hands of customers to be prepared, and if it is inconvenient to adjust the individual debtors' accounts in the Sales Ledgers, he should see that an entry is made debiting the Sales Account, and crediting a Suspense Account, with the value of the goods in the hands of customers at the date of the Balance Sheet, at the price at which they have been debited. This will have the effect of reducing the Sales to the proper figure, and in the Balance Sheet the credit balance on the Suspense Account should be deducted from the total Debtors, thus reducing the same to their actual figure. The stock in the hands of customers should then be calculated at cost or under,

and brought to the credit of Trading Account, appearing on the Balance Sheet as an asset.

(d) **Goods on Consignment.**

(1) *Consignor's Books.*

Following the principle that no profit should be taken until the sale is actually effected, where goods are sent on consignment, the Auditor should ascertain that profit has only been taken credit for in respect of goods actually sold prior to the date of the Balance Sheet. In practice, Consignment Accounts sometimes present features of difficulty, and should be subjected to careful scrutiny on the part of the Auditor. Where it is desired to show the profit or loss on each Consignment, a separate Consignment Day Book should be utilised, the goods sent out being passed through this book at cost, and debited to a Consignment Account. Any freight, insurance, or other expenses incurred by the Consignor should also be debited to the Consignment Account; and on receipt of the Account Sales from the Consignee an entry should be made, crediting the Consignment Account with the gross proceeds, and debiting the Consignee's Personal Account. The latter account will be credited with the Consignee's Commission and Charges, the Consignment Account being debited. The balance of the Consignment Account will then represent either profit or loss, unless some portion of the goods remain unsold, in which event they should be valued at cost, or under, as the case may be, and brought down as a debit balance on the Consignment Account, which will appear as an asset on the Balance Sheet.

Where such treatment is in force, the Consignment Account will represent a Trading Account in respect

of the Goods sent on Consignment, and consequently the sales in connection therewith will not go to the credit of Sales Account. The Auditor should ascertain that the goods have been actually charged up at cost, and inspect the Account Sales rendered by the Consignee, and any Account Current he may have furnished, which will respectively afford an indication of the Sales made, the Stock on Hand, if any, and the balance of the Consignee's Personal Account.

Although the system above described is the best where it is desired to ascertain the result of each Consignment, it is not always adopted in practice. Goods are not, as a rule, invoiced at cost price, but at an estimated selling price, sometimes for the purpose of insurance, and sometimes in order that the Consignee shall not be aware of the cost price of the goods. In such cases it is common to find the goods consigned treated as ordinary sales, and passed through the Sales Day Book, being debited to the Personal Account of the Consignee, who appears as a debtor in the Sales Ledger. If the goods remain unsold, or if the Consignment is not closed at the date of the Balance Sheet, and the necessary adjustments are not made, this treatment will be incorrect, as the Sales Account will have been credited, at the selling price, with goods consigned that have not yet been sold, and the Consignee will appear as a debtor, whereas he is only liable to account for the proceeds of the goods or the goods themselves. In such a case, the Auditor should see that the accounts are properly adjusted, and that consigned stock, remaining unsold, is brought in at a proper valuation, according to the circumstances.

Where it is not desired to keep a separate account in respect of each consignment, the goods, when

invoiced, should not be passed through the books, but should be recorded in a Memoranda Consignment Book. No amount should be debited against the Consignee's Personal Account until the Account Sales is received from him, when a Journal entry should be made, crediting Sales Account and debiting the Consignee's Personal Account with the amount of the Sales. A further entry should be made, crediting the Consignee with commission and expenses, and debiting the proper Nominal Accounts, when the balance of the Consignee's account will properly represent a debt due from or to him. It will be observed that, under this system, credit is only taken for goods actually sold, and consequently, stock remaining on consignment unsold must be agreed with the returns furnished by the Consignee, and brought into account at or under cost. Similar remarks apply to Agents' Accounts.

(2) *Consignee's Books.*

In auditing the accounts of a business where goods are received on consignment, and sold on behalf of a principal, the Auditor should ascertain that such sales are kept entirely distinct from the ordinary sales effected by the business. A separate Day Book should be kept to record such sales, the total thereof being posted to the credit of the Personal Account of the Consignor, and not to the Sales Account. In the same way, care must be taken to see that no consigned stock is included as part of the stock belonging to the business. For these reasons, it is desirable that no entries should be made in the Consignee's books (except the stock record in a Consigned Stock Book) until actual sales are effected, when the various debtors concerned will be debited, and the Consignor's Personal

Account credited. Commission and charges will be debited to the Consignor, and credited to the respective nominal accounts. The Auditor should ascertain by the inspection of contracts, correspondence, &c., the terms of the arrangement, and in cases of importance, a signed copy of the Consignor's Account should be obtained for purpose of verifying the balance. It is usually necessary to reconcile the balance of such account with the balance as shown by the Consignee's Ledger, owing to items not yet dealt with by the other party.

(e) Sales and Purchases for Future Delivery.

In certain businesses contracts are entered into for Forward Sales, delivery being made, either at stipulated times, or, as and when called for within a certain period. Although a valid contract may exist, it is not desirable that any profit should be taken in advance in connection with transactions of this nature, and the Auditor should ascertain that only those goods which have been actually delivered at the date of the Balance Sheet have been treated as sales. This particularly applies where the goods are not yet ready for delivery, and the necessary expenditure has not yet been incurred. Even where the goods at the date of the Balance Sheet are ready for delivery under contracts of this nature, they should be treated as stock at the date of the Balance Sheet, and valued at cost price. Cases will sometimes be found where the purchaser pays cash down for a quantity of goods, but does not take delivery of the whole, leaving a portion with the seller until the goods may be required. In such an event, it may be argued that the whole sale has taken place, and that profit can properly be taken in respect thereof,

the goods undelivered at the date of the Balance Sheet not being brought into stock, but being recorded as belonging to the purchaser, and held for his account. The Auditor must take all the circumstances into consideration in deciding whether this treatment can be permitted. The most prudent course is to treat as sales that proportion of the goods which have actually been delivered, leaving the purchaser a creditor for the remainder, profit on which will then be taken in the period in which they are delivered.

Similar considerations apply in the case of Forward Purchases. A Contract has been made either for purchase or sale as the case may be and the liability to give or take delivery exists. In some businesses where staple commodities are dealt with for delivery at long dates forward, the valuation of these transactions at the date of any Stock taking might alter the face of the Balance Sheet altogether. A note should therefore appear upon the Balance Sheet that there are Contracts current for the purchase (and/or sale) of goods for future delivery. It there is any loss as against current market prices for such future dealings, provision should be made therefor.

§ 4. -- Sales Returns.

The method of recording goods returned by customers should be inquired into by the Auditor. A Returns Inwards Book should be kept by the Gate Office foreman, recording the necessary particulars, which should furnish the basis of the entry made in the Sales Returns Day Book. The latter book should be cast by the Auditor, and the totals checked to the Impersonal Ledger. A certain number of the entries should be tested with the Returns Inwards Book, and in the

case of large items, it may be desirable to refer to the correspondence, &c. It should be seen that all Credit Notes are approved and initialled by a responsible official before being issued.

§ 5.—Packages and Empties.

The method of dealing with Packages and Empties varies very much in different businesses. Where empties are not returnable, the charge is included, as a rule, in the price of the goods, and is not shown separately. If so, the credit will be included in the Sales Account. If a separate charge is made, either a separate column should be provided in the Sales Day Book, or the Sales should be analysed, the proportion relating to empties being posted to the credit of the Empties Account, as against which the cost of the empties will have been debited.

Where the empties are returnable, they should be charged up to the customer, wherever possible; but, some customers object to this, and a memoranda system has to be adopted.

As the empties are returned, full particulars will be recorded by the Gate Office foreman in an Empties Credit Book, which will form the basis of the credit given to the customer, and will be entered either in an Empties Returns Book, or in a separate column provided in the Sales Returns Book. The detail will be posted to the credit of the customer, and the total to the debit of the Empties Account.

The Auditor will check the casts of this book, and test a certain number of the entries. It is usual to charge empties at a higher rate than cost price, credit being given, when the same are returned, either at this price or lower. As, however, the outstanding debtors

at the date of the Balance Sheet include charges for empties at the higher rate, the Auditor should see that a proper reserve is carried forward, representing the difference between the value of the empties outstanding at the rate charged, and the stock value of such empties.

Where packages are not charged up, but are chargeable unless returned, package columns should be provided in the Sales Ledgers, and the numbers of the packages sent to each customer recorded on the debit side of the account. As the empties are returned, corresponding numbers should be entered on the credit side in the memoranda columns; thus the balances on these columns should represent the empties in the hands of the customers at any given date. As the packages are not charged up, there will be no necessity for the Auditor to see that any reserve is made in respect thereof, but the packages in the hands of customers should be extracted at the date of the Balance Sheet, and valued for stock purposes at a proper valuation.

It is desirable that the Auditor should test the transactions relating to empties from time to time, in order to see that the system is properly carried out.

§ 6.—Allowances.

One of the commonest methods of concealing cash defalcations, is by putting through fictitious entries under the heading of "Allowances," and it is therefore of the utmost importance that the Auditor should examine the Allowances recorded, in order to ascertain

A separate Allowances or Credit Book should be utilised, which will be written up from the counterfoils or duplicates of the Credit Notes sent to the customers. Such Credit Notes or counterfoils should be initialled by the responsible manager of the department concerned, and the Auditor should test entries of any consequence where necessary, referring to "the correspondence, or to any other evidence available. The Allowances Book should be cast, and the totals checked to the Impersonal Ledger,

§ 7.—The Journal.

The use of the Journal is principally confined to recording opening, closing, and adjusting entries, and all entries of a special nature, for which no separate subsidiary book is in use.

The Auditor should check the postings to the respective ledger accounts, and ascertain that each entry is in order. Where necessary, narrative should accompany the entries, explaining the nature thereof, and referring to whatever evidence may be available for the purpose of substantiating the same. Such evidence will take the form of correspondence, contracts, minutes, resolutions, &c., and should be examined by the Auditor.

This operation is known as vouching the Journal, and in its way is as important as vouching the Cash, since Journal entries may be made which have material bearing on the complexion of the Accounts.

The following are some illustrations of Journal entries of importance which are continually met with :—Writing off Depreciation, providing Reserves for Bad Debts, &c., providing for Interest on Capital, bringing into account outstanding Assets and Liabilities; and,

in the case of Companies, entries relating to the issue of Share Capital, and the calls made in respect thereof, Appropriations of Profit, &c.

It is hardly necessary to mention that Day Books, both bought and sold, and Return Books, Bill Books, &c., are all forms of Journals specially ruled to record the particular class of transaction to which they are confined; another instance being a Transfer Journal to record transfers between one Personal Ledger and another, or one account and another.

The Auditor should check the casts of Journal entries composed of more than ~~one item~~. In some cases, both columns of the Journal are cast throughout the book, for the purpose of Sectional Balancing, in order that the analysis of the entries relating to each Ledger can be proved. Where this is done, it may be advisable for the Auditor to check the casts.

In those countries on the Continent where the Code Napoleon is in force, the use of the Journal is compulsory, and all entries, of whatsoever nature, have to pass through this book in one form or another. In this way, proper accounts can be prepared at any time from the material embodied in the Journal. The principle of passing everything through the Journal is adopted to some extent in this country, but is usually confined to journalising all the totals of the subsidiary books.

If the Trial Balance is taken out in four columns, the first two columns being utilised to record totals of each side of the Account, the remaining columns being utilised to record balances, the operation of the Journal in the manner above described will afford material assistance in localising errors to the debit or credit side, since the totals of the debit and credit columns

in the Journal for the period should equal the totals of the debit and credit total columns in the Trial Balance, if the Cash Book is also journalised.

✓ § 8. — The Bought Ledger.

In cases where the Auditor considers it necessary to check the whole of the detail of the Bought Ledger, the Purchases will be checked from the Purchase Journal, the Returns from the Returns Book, and the Cash and Discount from the Cash Book. Entries of a special nature should have been passed through the Journal, and will be checked from that book. The Ledger Accounts should be examined, to ascertain that every item has been checked by the Auditor, including the balances brought forward at the commencement of the period. The Ledger will then be cast, and the balances checked into the Balance Book, and cast.

Where it is not considered necessary to verify the whole of the detail work above referred to, the Auditor will utilise his judgment as to how far he considers it necessary for his examination to extend. Where the balances on the Bought Ledger can be separately proved, as referred to in § 10, the Auditor should check the Total Account representing the Bought Ledger, and see that the balance thereon agrees with the total of the individual balances.

In examining the balances on the Bought Ledger, the Auditor should see that the composition of each balance represents some definite item or items. If this is not apparent, and the account is of a complicated nature, it is desirable to examine the last statement rendered by the creditor, and compare it with

the ledger account, in order to see whether there are any items in dispute, in respect of which deductions or reserves ought to be made.

It has already been pointed out in § 1, that a common method of inflating the profits is to include Purchases in Stock, but to omit them from the Bought Journal, with the result that they are not debited to the Trading Account for the period to which they relate, and the party from whom they are bought does not appear as a creditor on the Balance Sheet. One method of ascertaining whether this has been done, has been suggested in connection with the audit of the Bought Journal, but a further check consists in examining the Creditors' Statements with the Bought Ledger. Where the Auditor considers it advisable to verify the balance of an account in this manner, he should call for the last statement, and, if this is not produced, he should insist on a duplicate being obtained.

Where goods, subject to Trade Discount, have been passed through the Purchase Journal without the deduction of the Discount, the Auditor should see that the necessary adjustment is made in the ledger account, so that the final credit balance is the amount actually payable.

Debit balances will occasionally be found on the Bought Ledger, representing Returns made after the goods have been paid for. If the item has been outstanding any length of time, and no further dealings have taken place, the Auditor should ascertain that the amount is recoverable, and does not represent items in dispute, or if it does, that provision is made accordingly. Where the debit balance is occasioned by the payment of cash, the presumption is that the corresponding credit representing the invoice for the goods

has not been passed through the books. Inquiry should be made to ascertain if this is the case, and if so, the outstanding liability should be provided for and the goods taken into stock. Where goods not delivered at the date of the Balance Sheet have been paid for in advance, a credit entry should be passed through the Bought Ledger Account, if the property in the goods resides in the purchaser, the goods being taken into stock as in transit, or as in the hands of the seller. Where the property in the goods has not passed, the item may remain as a debit balance.

When mutual dealings take place between two parties, it is usual to find an account in the Bought Ledger for Purchases effected, and one in the Sales Ledger for Sales effected. If each account is separately settled by cash, no difficulty will arise, but where the Bought Ledger account is settled by contra, the Auditor should check the entry, and examine the voucher acknowledging the contra payment.

§ 9.--Sales Ledgers.

(a) Internal Check.

It is important for the Auditor to ascertain whether there is any efficient system of Internal Check in operation as regards the Sales Ledgers, as defalcations of cash are frequently concealed by means of fictitious entries. Particular reference should be made to the following points : —

- (1) Whether the Cashier has any control over the Sales Ledgers, or any books of prime entry relating thereto, other than the Cash Book. If this is so, the opportunities for the concealment

of fraud on the part of the Cashier are considerable, and the Auditor should exercise additional caution accordingly.

- (2) Whether the Sales Ledger balances are capable of separate proof, by means of Total Accounts as described in § 10. If so, such accounts should not be under the control of the ledger clerks.
- (3) Whether the ledger clerks take any part in checking their own work. Where there is a sufficient number of clerks, no man should be permitted to do this, but in small businesses such an arrangement may be unavoidable.
- (4) The arrangements that are in force with regard to the collection of overdue accounts.
- (5) Regulations relating to the passing of Credit Notes for Returns, Allowances, Empties, &c. These have been dealt with above.

(b) The Verification of Postings.

The extent to which the Auditor may find it necessary to verify the postings in the Sales Ledgers will depend on the circumstances of each case. Where there is not a good system of Internal Check in operation, and the transactions are not too numerous, it may be desirable to check the whole of the postings from the books of prime entry to the Ledgers. Where this is not practicable, attention should be directed to the credit postings, since any attempt to conceal defalcations will more usually take the form of fictitious credit entries. The Cash and Discount postings should be checked from the debit of the Cash Book, and this is a convenient occasion for testing Discounts allowed, any amounts of importance deducted by way of discount after the term of credit has expired

being enquired into. The entries from the Bill Books, Returns and Allowances Books, &c., should also be checked, and the Auditor should go through each account to see that every item is ticked.

Where the Sales Ledgers are numerous, and there is a good system of Internal Check in operation, it will be sufficient for the Auditor to test the postings. This can be done either by taking an individual ledger and clearing that, or by taking individual accounts in different ledgers. It is preferable to clear any accounts that are selected, rather than to rely upon testing individual entries. Note should be taken of the ledgers selected for test, so that in the course of a period of years, the whole of the ledgers may come under notice in this manner.

(c) The Verification of Balances.

However good the system of Internal Check may be, and although Total Accounts may be in operation, which the Auditor may have verified, it is necessary that the individual balances on the Sales Ledgers should also be checked by him on to the Schedules, and the Schedules cast. It cannot be said that the Book Debts are properly verified unless the actual accounts representing the individual debts are examined by the Auditor.

From the Auditor's point of view it is most convenient if the balances on the Sales Ledgers are brought down at the date of the Balance Sheet, since these can then be checked by him on to the Schedules, and there is a clear record in the ledger of the balance of the account at the particular date in question. This is not always done, however, since it is sometimes found

more convenient to balance off each account at the time of settlement, rather than at any given date, and the additional labour of bringing down the balances at an arbitrary date is objected to by the lodger-keeper. Where this is so, the Auditor, although he may prefer that the balances should be brought down, is not usually in a position to insist upon this being done, but he is entitled to request that the balance of each account at the date of the Balance Sheet should be inserted in ink at the side of the account, according to whether it is a debit or a credit balance. Even this modest request may be refused occasionally, and the Auditor will then be obliged to enter the balance himself in ink at the side of the account, since it is highly undesirable for any balances to be checked on to the Schedules without some permanent record of the balance at that date appearing in the ledger account itself.

In extracting the balances it should be ascertained how the composition of each balance is made up, and whether it represents specific items of goods, or is an accumulated balance; and in the latter case, further examination should be made, as to the reason why the account is open; it may be due to errors or disputes in respect of which adjustments or reserves should be made.

Care should be taken to see that no Trade Discount is included in the balances. If it has been included, the Auditor should see that the necessary adjustments are made to reduce the account to the amount which is properly payable. Balances, including goods out on sale or return, goods on consignment, &c., require careful attention, and have already been dealt with in § 3.

✓ (d) **Bad and Doubtful Debts.**

It is not sufficient for the Auditor merely to satisfy himself of the correctness of the balances on the Sales Ledgers. It is also his duty to ascertain, from the evidence at his disposal, whether any of the balances represent debts which are not recoverable, and whether any are of a doubtful nature, against which reserves should be made.

In examining the balances for this purpose, the following points should be taken into consideration: -

- / (1) The term of credit allowed by the business.
- ✓ (2) The age of the debt.
- ✓ (3) Whether the account is regularly settled within the term of credit, and advantage taken of Cash Discount.
- / (4) Whether payments are being made on account, and if so, whether the balance has tended to increase.
- / (5) Whether an old balance is being carried forward to be paid off by instalments, new goods being supplied for cash.
- / (6) If payment has been made by Bill, whether any Bills have been dishonoured or retired.
- / (7) Whether any cheques have been dishonoured.
- / (8) Whether any notes have been made on the Ledger account relating to Suspension of Payments, Deeds of Arrangement, Bankruptcies, Liquidations, Receiverships, or of the placing of accounts in the hands of Solicitors or Debt Collectors.

Where the Ledger balances are at all numerous, the Auditor, before commencing his examination thereof, should ask that a Schedule of Bad and Doubtful Debts be prepared and presented to him, which should be certified by the manager, secretary, or other responsible

official, as representing, in his opinion, a complete list of all debts against which reserve should be made. Having obtained such a Schedule, the Auditor, as he checks the balances, will be in a position to see whether all those debts which appear to him to be bad or doubtful are included therein, and it will only be necessary for him to make further inquiries in respect of those debts which appear to him to be bad or doubtful, but which are not included in the Schedule as such. These should be marked on the Schedule of Ledger Balances, and gone through by the Auditor with some responsible official. If no certified list of Bad and Doubtful Debts is presented to the Auditor, he should mark on the Schedule of Ledger Balances all those he considers should be reserved against.

It is impossible to lay down any hard-and-fast rule as to the value of book debts. The term of credit allowed in different businesses differs considerably, and may vary even in the same business for different classes of goods; moreover, in certain cases, the terms of credit are not strictly adhered to, or special terms may be granted to individual customers. The Auditor, therefore, will require to exercise considerable judgment in arriving at an opinion, and each case must be taken on its merits. Where the average term of credit is three months, but certain accounts are settled half-yearly or yearly, so long as the settlement is regularly effected, there is no reason why the debt should be considered doubtful. Statute-barred debts, although they may in fact be good, should be reserved for in full, as there is no legal right to recover.

If payments have been made on account, and the balance against the debtor continues to increase, the Auditor should inquire into the circumstances of the

debt, and for this purpose it may be useful for him to consult any reports from Credit Agencies and others, as to the amount of credit that can be safely allowed, and where the amount of the debt is within such limit, and the report is of comparatively recent date, the account may be passed. The payment of an old balance by instalments, while new goods are paid for by cash, is nearly always a sign of weakness, and the old balance should, in such cases, be regarded as doubtful, and reserved against accordingly. If the debtor has an arrangement of this sort with one house, he probably has a similar arrangement with several of his other creditors, and default of payment of the agreed instalment in any one instance may result in pressure being put upon him, and cause subsequent insolvency.

The fact that Bills have been dishonoured or retired is evidence of weakness. If a reserve is considered necessary, and any Bills are outstanding on the account, they will, unless discounted, form part of the balance of the Bills Receivable Account, and a reserve should be made against them, accordingly. Where such Bills have been discounted, reserve should be made in respect of the contingent liability.

Returned cheques are not necessarily a sign that the account is doubtful, as the return may be due to errors in drafting or endorsement. Where, however, the cheque has been actually dishonoured, and especially where it was in the first instance post-dated, the account should be considered doubtful. .

Notes of Insolvencies, &c., are usually made at the head of the account concerned for the convenience of the ledger-keeper, and the information to be derived from them is of material advantage to the Auditor. In cases where the debt is of any consequence, the

papers relating to the matter should be examined, and *the Auditor will probably be able to form an opinion as to the proper amount of reserve which should be made, from the reports of the Trustees, Liquidators, &c.* Where final dividends have been declared, the balance of the account should be written off.

The fact that accounts have been placed in the hands of Solicitors or Agents for collection, does not necessarily imply that the account is bad or doubtful. There are a certain number of people who make a point of never paying until they are sued, and in these cases the account may be perfectly good. The Auditor should ascertain the date when the account was put into other hands, as, if any considerable period has elapsed since that time without payment being received, the account may be regarded as doubtful.

It is not desirable that debts should be written off until there is no further hope of recovering anything in respect thereof, since otherwise, the account may get overlooked, and any opportunity that may subsequently present itself of recovering the whole, or a portion, of the debt, lost accordingly.

Further, in the event of such debts being eventually paid, or dividends received in respect of them, opportunity is offered to the Cashier to appropriate the sum so received, owing to the fact that no debit appears in the ledger in respect thereof. In order to avoid this possibility, and at the same time to prevent a considerable number of bad debts remaining on the current ledgers, a Bad and Doubtful Debt Ledger is sometimes utilised, to which an account is transferred as soon as it becomes doubtful. In this way, a check can be kept on the Bad Debts, and the ultimate loss in respect of each account ascertained.

Bad Debts should not be written off without the sanction of some responsible official, in order to prevent the possibility of misappropriations being concealed by the creation of fictitious Bad Debts. Bad Debts written off during the period should be passed through the Journal, the entries being initialled by the official in question, and checked by the Auditor.

As regards the amount of reserve to be created in respect of bad and doubtful debts not written off, reserve should be made to the full extent of those debts actually regarded as bad, while the doubtful debts should be reserved according to their estimated value, which is usually placed at 5s. or 6s. 8d. in the £, special reserve being made in respect of debts of a large amount based on the circumstances of each case.

Where the debts are very numerous and of an average amount, the reserve for doubtful debts may be made by way of a percentage on the outstanding debtors, the rate of which will be arrived at from previous experience; but this should be supplemented by specific reserves, if necessary.

Bad debt dividends which have been received in respect of bad debts previously written off, should be carried direct to the credit of the Bad Debt or Bad Debt Dividend Account, and not placed to the credit of the debtor's account in the Sales Ledger, since there is no corresponding debit. It is often found that small credit balances unclaimed are written off, after a certain period, to the credit of the Bad Debt Account, though, strictly speaking, repayment should be made. Unclaimed credit balances of any consequence should be carried forward in suspense.

Where the Auditor, after careful investigation, is of opinion that the reserve for bad debts is insufficient,

he should endeavour to induce his clients to make the additional reserve which he considers necessary. If, however, he is unsuccessful, his only course is to refer to the matter in his Report or Certificate, stating to what extent he considers the reserve is inadequate. The question is one of material importance, since it directly affects the correctness of the Profit and Loss Account and the Balance Sheet.

§ 10. - Total Accounts and Sectional Balancing.

In a business of any magnitude, the difficulty experienced in balancing the books is very considerable, unless some method is adopted by means of which the balances of the Sales and Bought Ledgers can be respectively proved. This can be done by the construction of Total Debtors' and Creditors' Accounts, the Total Debtors' Account containing the totals of all items posted in detail to the debit and credit of the Sales Ledgers, and the Total Creditors' Account the totals of all items posted to the debit or credit of the Bought Ledgers. The balance on the Total Debtors' Account should, at the end of any given period, equal the total of the individual debit balances on the Sales Ledgers, less any credit balances; and correspondingly, the balance of the Total Creditors' Account should equal the net balances on the Bought Ledgers.

The advantages to be derived from utilising a system of this nature are as follows:—

- (1) A Trial Balance of the Impersonal Ledger can be prepared, including the balances of the Total Accounts, thus enabling draft or interim accounts to be drawn out, without taking out the individual personal balances.

- (2) Errors can be located.
- (3) If these accounts are not under the control of the ledger clerks, they can be made to form an important part of the internal check, for which purpose it is not desirable that they should be recorded at the end of the Sales or Bought Ledgers, as is sometimes suggested, but in the Impersonal Ledger, or in a separate book kept for the purpose.

For the effective operation of this system it is essential that every transaction recorded in the ledgers should first be passed through a book of prime entry, since it is from the totals of the books of prime entry, as relating to the Sales and Bought Ledgers respectively, that the Total Accounts must be compiled. No transfers, therefore, should be made in these ledgers without passing either through the Journal, or through a separate Transfer Journal.

(a) Total Debtors' Account.

On the debit side of the Total Debtors' Account will be found:—

- (1) The opening debit balances brought down from the previous period, which should agree with the total of the last Schedule of Debtors.
- (2) Sales from the totals of the Sales Day Books.
- (3) Cash payments, returned cheques, &c., from the analysis of the payments side of the Cash Book.
- (4) Dishonoured Bills, Transfers, Interest, Discount, &c., which will be obtained from the analysis of the Journal or Transfer Journal.

On the credit side of the Total Debtors' Account will be found :—

- (1) Opening credit balances (if any), representing the total of the balances which were in credit at the close of the preceding period.
- (2) Cash received in respect of Debtors. In order to obtain the total of the cash received, a separate column should be provided in the Cash Book, in which should be extended all items relating to the Sales Ledgers.
- (3) Discount Payable from the totals of the Discount column on the debit side of the Cash Book.
- (4) Returns Inwards and Allowances from the totals of the respective Day Books.
- (5) Bills Receivable from the Bills Receivable Book.
- (6) Bad Debts, Transfers, and other special items (if any) from an analysis of the Journal or Transfer Journal.

The balance of the Total Account, so compiled, should equal the net total of the individual balances on the Sales Ledgers. If there is any difference, either the Total Debtors' Account is incorrect, or there is some error in the Sales Ledgers. The correctness of the Total Account is *primâ facie* proved if the Impersonal Trial Balance, which should include the balance of the Total Debtors' and Creditors' Accounts, agrees. At the same time, if there is any error in the cast of those books of prime entry, the totals of which are posted to the Impersonal Ledger, such error will be counterbalancing, and will not affect the Trial Balance of the Impersonal Ledger, though it will cause the Total Debtors' Account to disagree with the balances on the Sales Ledgers. For instance, the Sales Day Book may be overcast £100, but as the total is posted to the credit of Sales and to the debit of the Total

Debtors' Account, the error will not be discovered by the Impersonal Trial Balance. It is therefore essential that all the casts of the books of prime entry should be checked before it is assumed that the error resides in the Sales Ledgers.

(b) Total Creditors' Account.

On the credit side of the Total Creditors' Account will be found :-

- (1) The opening credit balances brought down from the previous period, which should agree with the total of the last Schedule of Creditors.
- (2) The Purchases from the totals of the Purchase Journal.
- (3) Transfers and other special items from the analysis of the Journal or Transfer Journal.

On the debit side will be found :-

- (1) Opening debit balances (if any) brought down from the previous period.
- (2) Cash paid to Creditors, the totals being derived from a special column provided on the credit side of the Cash Book, into which all payments relating to the Bought Ledger should be extended.
- (3) Discount Receivable, from the totals of the Discount column on the credit side of the Cash Book.
- (4) Bills Payable, from the total of the Bills Payable Book.
- (5) Returns Outwards and Allowances, &c., from the totals of those books.
- (6) Transfers and other special items from the analysis of the Journal or Transfer Journal.

The closing balance should equal the net balances on the Bought Ledger.

(c) Sectional Balancing.

In small businesses, where there are only a few Ledgers, the system of compiling Total Accounts for Debtors and Creditors respectively is sufficient for all practical purposes, but, as soon as the number of Ledgers increases, some further extension of the principle becomes necessary, if balancing is to be effected accurately and promptly. Where, for instance, there are five Sales Ledgers, only one Total Debtors' Account being compiled, representing the whole of these Ledgers, and it is found that a difference exists, there will be no means of locating the difference as between one Ledger and another. In order to overcome this difficulty, separate Total Accounts should be compiled for each particular Ledger.

Where the number of Ledgers employed is not very great, it is sometimes found possible to provide separate columns for each Ledger in the Cash Book, and other books of prime entry ; but this method becomes too cumbersome where the Ledgers exceed three or four in number, owing to the space occupied by the rulings. It therefore becomes necessary to adopt some system of analysis. At the end of every month, each book of prime entry should be analysed for the entries it contains relating to each Ledger, and a Summary prepared thereof, the total of which should agree with the total of the book of prime entry. When the figures of the analysis are agreed, the totals relating to each Ledger should be entered in a Summary Book, which should have separate columns or pages for each Ledger. When all the requisite totals have been inserted, and the balances relating to each Ledger carried forward from the preceding period, the final balance relating to each Ledger should agree with the

net balances on that Ledger, and in this manner Total Accounts for each Ledger will be constructed.

Where systems of the nature above described are in force, the Auditor's work in connection with the Personal Ledgers will be materially facilitated. The Total Accounts will be checked or tested, and it should be seen that the balances thereof agree with the net balances on the Personal Ledgers. If it is arranged that the clerks who take out the Ledger balances should not be concerned with the posting of those particular Ledgers; that no Ledger balances should be extracted by the clerk who prepares the analysis for entry in the Summary Book; and that that book is under the control of some responsible official, no ledger clerk being allowed access to it, the internal check will be a very effective one, and it will be unnecessary for the Auditor to spend much time in checking the detail of the Personal Ledgers.

§ 11.—Loose Leaf and Card Ledgers.

The utilisation of Loose Leaf Ledgers is now very usual, and in many cases these undoubtedly possess considerable advantages over ordinary Ledgers.

The advantages to be derived from utilising Loose Leaf Ledgers are, that it is unnecessary to open new Ledgers altogether at any one date, owing to the fact that the Ledgers are continuous, additional pages being inserted as required; and that closed and dead accounts can be withdrawn from the Ledger and filed separately, thus avoiding a large number of such accounts being retained in the current Ledgers.

On the other hand, the system is subject to certain disadvantages. There is a possibility of sheets being accidentally lost or destroyed, though this should not occur where proper supervision is effected. A more serious danger exists in the possibility of fraudulent substitution of one sheet for another, in order to conceal defalcations, and the Auditor should make inquiries into the system in force for the custody of these sheets. The keys of the Ledger should be kept under the sole control of some responsible official, and similar control should be exercised over the stock of loose sheets. No sheet should be taken out of any Ledger until the matter contained therein has been passed by the Auditor. All sheets so withdrawn should be filed in order.

It has been suggested that Loose Leaf Ledgers might not be deemed sufficient evidence in a Court of Law, owing to the possibility of substitution, but as the entries in any account can usually be substantiated by other evidence, this point need not be seriously considered.

Card systems differ from Loose Leaf systems, inasmuch as each Ledger Account is contained on a card, the cards themselves being filed in cabinets. The disadvantage of this system is, that whenever an entry has to be made, the card has to be taken out of the cabinet for the purpose of writing on it, and as this operation has to be effected continuously, the same measure of control cannot be exercised to avoid the possibility of substitution or loss. As a result, the system is more adapted to memoranda purposes than to actual account-keeping, though where there are a very large number of accounts, the entries in which are comparatively infrequent, it may be found con-

venient. In other respects the same remarks apply to the Card system as to the Loose Leaf system referred to above.

Another advantage which Card Ledgers undoubtedly possess over ordinary Ledgers, is that at balancing periods the work of checking and agreeing the accounts can be divided over as large a number of clerks as the prime entry records permit. This may save considerable time, and prevent the current work getting into arrear. Such a procedure should not be allowed with Loose Leaf Ledgers since this would involve unlocking the binders and leaving the leaves free; but separate binders in which the leaves can be locked during use can be provided to enable the work to be divided if it is desirable.

SYNOPSIS OF CHAPTER IV.

The Audit of the Impersonal Ledger.

§ 1.—THE IMPERSONAL LEDGER.

2.—OUTSTANDING LIABILITIES AND ASSETS.

(a) Outstanding Liabilities.

- (1) Purchases.
- (2) Wages.
- (3) Rent, Rates, &c.
- (4) Freight.
- (5) Trade Expenses.
- (6) Legal Expenses.
- (7) Audit Fee.
- (8) Travelling Expenses.
- (9) Travellers' Commission.
- (10) Interest on Loans.

(b) Outstanding Assets.

- (1) Rents Receivable.
- (2) Interest and Dividends.
- (3) Commission Receivable.
- (4) Rent, Rates, &c., paid in advance.
- (5) Insurance paid in advance.
- (6) Advertising.

3 —APPORTIONMENT OF EXPENDITURE BETWEEN CAPITAL AND REVENUE.

4.—DEFERRED REVENUE EXPENDITURE.

- (a) Alterations to Plant.
- (b) Advertising.
- (c) Preliminary Expenditure in connection with a new business.

5.—THE VALUATION OF ASSETS.

- (a) Fixed Assets.
- (b) Floating Assets.
- (c) Wasting Assets.

6.—DEPRECIATION.

- (a) General Considerations.
- (b) The Principal methods of providing for Depreciation as affecting different classes of Assets.
 - (1) Freehold Land.
 - (2) Freehold Buildings.
 - (3) Leasehold Land and Buildings.
 - (4) Fixed Plant and Machinery.
 - (5) Loose Plant and Tools.
 - (6) Furniture.
 - (7) Fixtures and Fittings.
 - (8) Patents.
 - (9) Copyrights.
 - (10) Horses.
 - (11) Goodwill.

7.—REPAIRS AND RENEWALS.

8.—RESERVES.

- (a) General Reserves.
- (b) Specific Reserves.
 - (1) Reserve for Bad Debts.
 - (2) Reserves for Discount.
 - (3) Reserve for Depreciation of Investments.
 - (4) Insurance Reserves.

9.—CONTINGENT LIABILITIES.

CHAPTER IV.

THE AUDIT OF THE IMPERSONAL LEDGER.

§ 1.—The Impersonal Ledger.

In the two previous chapters, the duties of the Auditor in relation to the examination of the books of prime entry and the Personal Ledgers of a Trading Business have been considered, and it is now proposed to deal with the Impersonal Ledger, and the points that will require to be considered by the Auditor in connection therewith. The verification of assets is a subject of great importance, and will be more conveniently dealt with in the succeeding chapter. Similarly, questions particularly affecting Limited Companies will more properly be considered in the chapters dealing with Company Audits. There remain, however, a large number of questions common to most classes of accounts, which particularly affect the ascertainment of profit or loss, and involve the consideration of important principles.

Ledger Accounts may be divided primarily into two classes—Personal, and Impersonal.

Personal Accounts record dealings with persons, and, in the case of a Trading Business, consist principally of the accounts of persons from whom goods are bought, or to whom goods are sold, being recorded in the Bought and Sold Ledgers respectively. There remain, however, a certain number of Personal Accounts which will be found in the Impersonal Ledger, such as

Loan Accounts, Partners' Capital and Current Accounts, &c.

Impersonal Accounts record the aspect of transactions as they affect the business, and not as they affect persons, and may be subdivided into *Nominal Accounts*, which relate to profit or loss, and *Real Accounts*, which record assets.

The Impersonal Ledger, therefore, should contain the whole of the accounts affecting the composition of the Trading and Profit and Loss Account, and all accounts representing Assets and Liabilities, other than those contained in the Personal Ledgers. The term Impersonal Ledger is not always utilised ; sometimes the phrase General Ledger is employed, and in certain cases a Nominal Ledger will be found, which should only contain accounts relating to profit or loss. In most businesses a Private Ledger is utilised to contain accounts of an essentially private nature. Such variations of detail will be determined according to the convenience of each particular business, and the term Impersonal Ledger is here utilised as covering all those accounts not included in the Personal Ledgers.

Except in very large businesses, the amount of detail in the Impersonal Ledger is not excessive, and the Auditor will be able to check the whole of the entries. This is important since, if the Auditor is able to verify the correctness of the Impersonal Accounts, this fact in itself will go a considerable way towards proving the correctness of the Personal Accounts, at any rate in total, since one of the commonest methods of concealing manipulations in Personal Accounts is to make a corresponding fictitious entry in an Impersonal Account.

The entries in the Impersonal Ledger will come either from the totals of the subsidiary books of prime

entry, from the Journal, or from the Cash Book. The casts of the various books of prime entry, such as the Bought and Sold Day Books, Returns and Allowances Books, Bill Books, &c., having been verified, the monthly totals thereof should be checked to the accounts in the Impersonal Ledger to which they relate. Where the totals have been subject to analysis, such analysis should be cast and proved, and the individual items composing it checked to their respective accounts in the Impersonal Ledger.

Many important transactions of an Impersonal nature are recorded through the Journal. The vouching of such entries has already been dealt with, and when this is being performed by the Auditor, he should see not only that there is sufficient evidence available for the entry, but that the entry itself properly records the transaction. If this has been done, the actual checking from the Journal into the Impersonal Ledger becomes a matter of detail. In order to avoid a multiplication of entries in the Journal, it is common to find many transactions of an important nature recorded by means of a mere transfer from one account to another in the Impersonal Ledger. This practice cannot be recommended. The tendency to reduce the number of entries in the Journal as much as possible for the purpose of saving labour, though admirable in itself, may be carried too far, and it will be frequently found, where transactions of an important nature are recorded by direct transfer in the Impersonal Ledger, that no narrative is inserted explaining the origin and nature of the entry. Such a transfer, however, may have the most important consequences on the accounts. An item may be transferred from the credit of a Revenue account to the debit of an

Asset account, thereby directly affecting the profits of the undertaking. The Auditor should, therefore, examine and vouch such transfers in the same manner as if they had been passed through the Journal. The postings from the Cash Book to the Impersonal Ledger should be checked in detail. It has already been remarked that, when vouching the Cash Book, the Auditor should particularly observe each item not posted to a Personal Account, and satisfy himself, from the nature of the evidence available, that the account to which it has been posted in the Impersonal Ledger is the correct one. Frequently, however, the particulars recorded in the Cash Book are insufficient to indicate the account to which the item should be posted. In such cases it is advisable for the Auditor to note against the item sufficient particulars to enable him to assure himself, when the posting is checked, that the item has gone to the correct account.

The whole of the postings having been checked, and the ledger accounts examined to see that every item has been ticked, the casts should be verified, and the Auditor will then be in a position to check the balances.

In cases where the books are presented to the Auditor balanced, and accounts prepared for submission to him, it is advisable that he should not examine the Impersonal Ledger until the whole of the entries have been completed, the necessary adjustments made, and the accounts closed off. He can then check the balances direct to the Trading and Profit and Loss Account, the Balance Sheet and its Schedules. In many cases, however, the Auditor is called upon to act in his capacity as Accountant, and make the necessary adjusting entries; draft out final accounts

for submission to his clients, and close the Impersonal Ledger when these have been approved. Where this is so, the Auditor will check the balances of the Impersonal Ledger to the Trial Balance that is produced to him, and utilise that as a basis from which to make the necessary adjusting entries and prepare the final accounts.

The distinction between the Auditor, in his capacity as Auditor, and in his capacity as Accountant, has already been referred to in Chapter I., and need not again be discussed here; but whether the Auditor makes the adjusting and closing entries, or merely audits them, he must satisfy himself that those entries are correct, and that all the necessary adjustments, of which he has knowledge, have been made.

§ 2. Outstanding Liabilities and Assets.

In a business of any size, there are always a considerable number of adjustments to be made on the occasion of each balancing period for the purpose of properly recording outstanding liabilities and assets, which for some reason or other have not already been brought into the accounts. In such cases it is very convenient to utilise a memoranda book, which may be termed an Outstandings Book, in which all particulars of outstandings are entered at each balancing period, and which can thus be made to form the basis from which the adjusting entries are constructed. Such a book will be found particularly useful by the Auditor, as it will afford a ready means for the comparison of outstandings as between one period and another, and act as some sort of reminder of the nature

of the adjustments usually necessary in the particular business concerned, which will not as a rule be found to vary very much from year to year.

Where an Outstandings Book of this nature is in force, it is advisable for the Auditor to obtain a certificate from some responsible official, to the effect that all the Outstandings within his knowledge that require to be dealt with have been included therein. Such a certificate will not relieve the Auditor from the necessity of exercising reasonable skill and diligence in the matter, but he cannot possibly be aware of all the Outstandings, and the certificate serves to fix the responsibility for any omission.

Where an Outstandings Book of this nature is utilised, the necessary entries can be made direct in the Impersonal Ledger, reference being made to the folio of the Outstandings Book for the narrative relating to the entry. In the absence of such a book the entries should be recorded through the Journal, the necessary narrative being inserted. As regards outstanding liabilities, it is very usual to find the various Impersonal accounts debited, and a Sundry Creditors account credited. This method, however, although perfectly sound and convenient at the date of closing the books, involves writing back the entries at the commencement of the next period, since the items are not always identical with the payments made. It is preferable, therefore, to bring an outstanding liability down as a credit balance on the Impersonal Account concerned, and in a similar manner to bring an outstanding asset down as a debit balance. Care should be taken that such balances are treated as Liabilities and Assets respectively in the preparation of the Accounts, as although they appear as balances

on the Impersonal Accounts, they are in effect Personal Balances in many cases.

(a) **Outstanding Liabilities.**

The inclusion of all known liabilities in the Accounts is of great importance, inasmuch as it directly affects the correctness of the Profit and Loss Account. It is therefore one of the duties of the Auditor to ascertain that all outstanding liabilities are dealt with. At the same time this is not always an easy matter, as a liability may be suppressed or concealed, and the books may contain no indication of its existence. There are, however, certain classes of Outstanding Liabilities which are common to most businesses, and the existence of which, though not recorded in the books, should be apparent to the Auditor from the nature of the transactions. The existence of other Liabilities, though not so apparent, may be suggested to the Auditor by his experience. The more usual of these will now be dealt with.

(1) *Purchases.*

In some instances invoices relating to Purchases that have been taken into Stock are received too late to be included in the Purchase Journal before the Accounts are closed, and may consequently have been entered in the succeeding period. A Schedule of these should be prepared, and the total debited to the Purchases Account, and brought down as an Outstanding Liability. Where the precise amount of the Liability cannot be ascertained, an estimate should be made and signed by some responsible official.

(2) *Wages.*

In the case of a manufacturing business, where the date of the Balance Sheet happens to fall in the middle of the Wages week, the proportion of Wages accrued should be calculated and brought down as a liability.

(3) *Rent, Rates, &c.*

It should be seen that all rents payable have either been paid to the last quarter day, or that the outstanding Rent is brought in as a liability. Where the date, on which the Accounts are closed, falls between the dates at which the rent is payable, the rent accrued to date must be calculated and brought into account, though it will not be payable till the succeeding quarter day. The same remarks apply to Rates, though, as these are usually payable in advance, the adjustment necessary will then come under the heading of Outstanding Assets. On the occasion of the first Audit, it may be found that expenditure of this nature has been dealt with on a cash basis in the past, and that the inclusion of the Outstanding Liabilities will result in the current period being charged with a greater proportion than properly relates to it. Notwithstanding this, the accounts should be adjusted, special note being made of the additional charge incurred by reason thereof. The Accounts will then be placed on a correct basis, and the Balance Sheet will show the true position of affairs.

The treatment of Income Tax under Schedule D is dealt with in Chapter IX., § 13.

(4) *Freight.*

Carriage and Freight Accounts may not be rendered till some time after the period has elapsed to which

they relate, and it is often necessary to close the accounts before they are received. In such a case, the amount outstanding must be estimated, and a comparison with the corresponding items of the previous year will afford a useful indication of the probable amount outstanding, if the business is of a regular nature. Payments for Freight are usually posted direct to the Impersonal Account, and the Auditor should be able to ascertain, from his examination of the Freight Account, the period in respect of which any liability is outstanding.

(5) *Trade Expenses.*

A Schedule of the Expenses outstanding should be prepared, and the total brought down as a liability on the Trade Expenses Account. It will be found, usually, that certain classes of expenditure are outstanding, particularly where no Personal Accounts are kept in the Bought Ledger for the Creditors concerned.

(6) *Legal Expenses.*

Solicitors frequently allow some time to elapse before sending in accounts to their clients, and consequently legal expenses may be outstanding, and should be provided for. Where no account has been received from the Solicitor, an estimate should be obtained from him of the amount of his costs up to the date of the Balance Sheet.

(7) *Audit Fee.*

The question as to whether the Audit Fee relating to the period covered by the accounts should be brought in as a liability at the date of the Balance Sheet has been much discussed, and still remains an open point. In some cases the Audit may not have

been commenced till after the date at which the accounts were closed, in which event it cannot be properly said to be a liability at the date of the Balance Sheet. In any case only a part of the work will have been performed. On the other hand the work involved relates to the period covered by the accounts, and it is certainly advisable that the Audit Fee should be treated as an outstanding liability. Similar remarks apply to Accountancy Charges for the preparation of the accounts, &c. In cases where the fee has not yet been agreed upon, but is dependent on the amount of work involved, an estimated amount may be brought in as outstanding.

(8) *Travelling Expenses.*

A Schedule should be compiled of all Travelling Expenses due to Travellers and others up to the date of the Balance Sheet, and these can be verified by the Auditor, since they will probably have been paid early in the succeeding period.

(9) *Travellers' Commission.*

The Travellers' Commission Account in the Impersonal Ledger should be examined and tested with the Commission Books relating to each Traveller. It will be found, usually, that the Commissions in respect of Sales for the closing month of the period will not have been paid till the succeeding month, and the amounts due must therefore be brought in as outstanding. If any sums have been paid to individual Travellers on account, only the balance of the commission due should be brought into account. Sometimes it is found that the advances exceed the amount of commission payable, and in that case the excess of

the amount advanced over the amount due is in effect a loan, and should be brought down as an outstanding asset, and treated in the Balance Sheet as a debtor, reserve being made where necessary. The system of allowing travellers to collect debts and set off the amount so collected against the sums due to them for commission and expenses, is very undesirable, and the Auditor should recommend its discontinuance. Where it is in force, the Auditor should ascertain that the various debtors' accounts have been credited, and Commission and Expenses Accounts debited, with the amounts retained.

In some cases a traveller is not paid commission until the goods ordered through his agency have been paid for in cash ; in other cases part of the commission is paid on execution of the order, and the balance when the goods are paid for.

Where arrangements of this nature are in force, the Auditor should ascertain that proper reserves have been made for outstanding commission that will become payable in respect of goods sold prior to the date of the Balance Sheet.

Sometimes the arrangement with the traveller provides that returns, allowances, and bad debts in respect of orders upon which commission has already been paid are to be brought into account in arriving at the current commission. If this is so, the Auditor should ascertain that the proper deductions have been made.

(10) *Interest on Loans.*

All interest due or accrued should be calculated at the proper rate, and brought in as an outstanding liability.

(b) Outstanding Assets.

There are two classes of Outstanding Assets which may require to be dealt with: firstly, items accruing or due, not recorded in the books, which will ultimately be received in cash; and, secondly, expenditure already incurred, some portion or the whole of which relates to a period subsequent to the date of the Balance Sheet. The latter class is usually termed *Expenditure paid in advance*, and the items of which it is composed should be shown in the Balance Sheet in one total under that heading. On no account should such items be included as Sundry Debtors. In order that the Profit and Loss Account may be correctly stated, it is important that on the one hand only expenditure relating to the period under review is included, and that on the other hand all income accruing, that is reasonably certain to be received, is brought into account. It is inadvisable, however, to bring into account any income due or accrued which is not likely to be received, unless at the same time it is fully reserved for.

Expenditure which is not strictly apportionable in respect of time, but the benefit of which has not been entirely received during the period under review, may in many cases be properly carried forward in Suspense, and written off over a period of years. The treatment of such items will be dealt with in § 4.

The following are the more usual classes of outstanding assets:—

(1) Rents Receivable.

All Rents receivable due or accrued to the date of the Balance Sheet should be calculated and brought into account, reserve being made for doubtful or irre-

coverable arrears, allowances for repairs, Schedule A Income Tax, &c.

(2) *Interest and Dividends.*

Interest receivable on loans accrued to the date of the Balance Sheet should be brought into account in all cases where the interest is regularly paid on the due dates. If the interest is in arrear, the amount accrued should either be omitted, or brought into account, and a corresponding reserve made against it. Dividends on Stocks bearing a fixed rate of interest, which it is known will be received in due course, may be calculated and brought into account, in so far as they are accrued at the date of the Balance Sheet. Dividends on Ordinary shares, however, should not be brought into account unless they have been received subsequently, when the amount so received can be apportioned.

(3) *Commission Receivable.*

Commissions due or accrued should be brought into account, but before passing the item the Auditor should examine the basis on which the calculation is made, and satisfy himself that the amount will be duly received.

(4) *Rents, Rates, &c., paid in Advance.*

Rent is sometimes payable in advance, and the amount so paid relating to the period subsequent to the date of the Balance Sheet can be carried forward. Rates, &c., are usually payable in advance, and where paid prior to the date of the Balance Sheet, similar considerations apply as in the case of Rents paid in advance. The Auditor should examine the Demand Notes to ascertain the period to which the Rates, &c., apply.

(5) *Insurance Paid in Advance.*

Insurance is payable in advance, and in the case of a large business the premiums payable in respect of fire, burglary, and workmen's compensation may be considerable. The proportion thereof applicable to the period subsequent to the date of the Balance Sheet should be calculated, and brought down as an outstanding asset. The last premium receipts will have been inspected in the course of vouching, and the Auditor should refer to the actual Policies if he considers it desirable.

(6) *Advertising.*

Payments are frequently made in advance under advertising contracts, and the proportion thereof relating to any period subsequent to the date of the Balance Sheet should be carried forward. Stock of advertising material, such as posters, enamelled iron signs, samples, &c., if not obsolete, may be valued at or under cost, and carried forward as an asset, depreciation, where necessary, being allowed for. This subject is further considered in § 4 (b).

§ 3.—**Apportionment of Expenditure between Capital and Revenue.**

The distinction between Capital and Revenue is of vital importance as affecting the amount of profit or loss, and the correctness of the Balance Sheet.

Capital Expenditure may be said to be all expenditure incurred for the purpose of acquiring assets of a permanent nature, by means of which to carry on the business, or for the purpose of increasing the earning capacity of the business.

Revenue Expenditure is all expenditure incurred in carrying on the business, and in maintaining the Capital assets in a state of efficiency.

The allocation of expenditure as between Capital and Revenue calls for the Auditor's careful examination. Where the expenditure is directly incurred for Capital purposes, it can be vouched by the Auditor in the course of his examination of the Cash Book, or the Bought Journal, and his duties in this connection have already been dealt with. In many cases, however, the expenditure takes the form of wages of workmen either wholly or partially employed on Capital improvements and extensions, but whose wages are included in the General Wages Account. Unless, therefore, a transfer is made from the Wages Account to the debit of the Asset Account concerned, Revenue will be charged with wages which may properly be capitalised. Before passing any such transfer the Auditor should examine the basis upon which it has been calculated. In these cases general estimates are unreliable and insufficient; precise particulars should be furnished of the number of men employed, the nature of their work, rate of pay, &c., and the proportion thereof applicable to Capital. Such analysis should be certified by the Wages Clerk as to calculations, and by the foreman as to the work done and the nature thereof, and finally by the Works Manager as being correct, and properly chargeable against Capital. Expenditure in the shape of Wages on Repairs or Renewals should be charged to the Repairs and Renewals Account, and not to the Asset Account.

Similar considerations apply to expenditure on materials which cannot be directly allocated to Capital purposes at the time of purchase. Schedules of all

goods taken from Store for such purposes should be prepared and certified by the Storekeeper and Works Manager, the values being calculated at cost price.

Where expenditure of this nature amounts to a considerable sum, it is advisable for the Auditor to refer to the matter in his Report, stating that he has accepted the certificates of responsible officials as to the correctness of the allocations.

Where obsolete Plant is replaced, the cost of pulling down the old Plant should be charged to the Old Plant Account, and the cost of erecting the new, to the New Plant Account. The balance of the Old Plant Account, less any credit for the residual value of the Old Plant, will represent a loss, which should be written off to Revenue at once, or over a short period of years.

§ 4.—Deferred Revenue Expenditure.

Reference has already been made to certain classes of expenditure which are primarily of a Revenue nature, but the benefit of which is not exhausted during the period covered by the Profit and Loss Account. Such expenditure may be conveniently termed Deferred Revenue expenditure, and it may be carried forward and written off within the period during which the benefit arising from it is likely to be felt, in order to avoid an unduly heavy charge being made against the profits in any one year.

Where it is proposed to carry forward expenditure of this nature, the Auditor should inquire into the facts of the case before he permits this treatment to be adopted, since it is sometimes resorted to for the purpose of inflating the profits.

The following are specific instances where this method may be utilised : —

(a) Alterations to Plant.

Heavy expenditure may be incurred for the purpose of improving plant and machinery, or adapting the same to altered conditions of trade, which cannot be strictly regarded as Capital expenditure, but which does in a sense improve the earning capacity of the business. This expenditure may be carried forward, and written off over a period of years, say from three to five, where no provision already exists in the shape of Depreciation or Renewal Funds, against which it may be debited. The nature of the expenditure should be clearly stated in the Balance Sheet, and the Auditor should draw attention to the treatment of it in his Report.

Similar considerations may apply in the case of heavy renewals occasioned by scrapping obsolete plant.

(b) Advertising.

Abnormally heavy expenditure on Advertising is frequently incurred in the course of establishing a new business. Where such expenditure is on a large scale, it is in fact a form of Capital expenditure, and may actually be capitalised under the heading of Advertising Goodwill. Goodwill of this nature, however, cannot be maintained unless considerable advertising is continued in subsequent years, and therefore a certain proportion should be written off to Profit and Loss. The balance may be carried forward permanently as an asset, though it is preferable to write it off over a period.

Where the expenditure on Advertising is not incurred for the purpose of creating an entirely new business, but is nevertheless of an abnormal nature owing to the placing of some new product on the market, or the opening of some new department, the average annual charge for advertising should be estimated, and such amount written off to Profit and Loss, the balance being carried forward and appearing separately in the Balance Sheet as Advertising Suspense. The Auditor should ascertain that the amount so written off is adequate, and that the Suspense Account is not carried forward over an unreasonable length of time.

Similar considerations apply to businesses where the advertising is not continuous, but heavy expenditure is incurred from time to time. In seasonal trades, expenditure may be made in connection with a new season, the benefit of which may not be felt before the accounts are closed. In such cases a proper proportion of the expenditure may be carried forward.

(c) Preliminary Expenditure in connection with a New Business.

Heavy preliminary expenditure may be incurred in connection with the commencement of a business, or the institution of a new department, before the same can reach a revenue-earning stage. Such expenditure may take the form of Rent, Rates and Taxes, Salaries, Wages and General Charges; and in order to avoid unduly burdening the Profit and Loss Account of the first period, it may be properly carried forward, and written off over a period of three or five years. In such a case the Auditor should ascertain that all current expenditure incurred after the revenue-earning stage has been reached is charged to the Profit and Loss Account.

§ 5.—The Valuation of Assets.

It may be convenient here to indicate the general principles which should be applied to the valuation of assets in a Balance Sheet. The legal aspect of the subject as affecting Limited Companies will be dealt with in Chapter X.

(a) Fixed Assets.

Fixed Assets are those of a permanent nature, by means of which the business is carried on, and which are held for the purpose of earning income, and not for the purpose of sale, *e.g.* Land, Buildings, Plant and Machinery, &c.

Such assets should be shown in the Balance Sheet at cost price, less any depreciation that may have taken place. The net figure will represent the present value of the assets to the business as a going concern. It is not necessary to take into account the market value of Fixed Assets, which may be subject to considerable fluctuation; the question to consider is the present worth of the assets to the business as a going concern, and not the break-up value. In the event of a forced realisation, heavy losses would probably ensue, but it would not be reasonable to anticipate such losses before arriving at the current profits of the business.

(b) Floating Assets.

Floating or Circulating Assets are those in which the business deals, and which are acquired for the purpose of sale, and the subsequent stages of the conversion of the same into cash, *e.g.* Stock, Book Debts, Cash.

The valuation of Floating Assets should be at cost or market price, whichever is the lower at the date of

the Balance Sheet. The object of the business being to convert Floating Assets into cash, and make a profit on dealing in them, it becomes a point of the utmost importance that the valuation placed on these assets at the date of the Balance Sheet shall be such that any loss sustained in connection therewith may be taken into account.

(c) Wasting Assets

Wasting Assets are those of a fixed nature which are gradually consumed or exhausted in the process of earning income, *e.g.* a Mine, Cemetery, &c.

It will be seen that Wasting Assets are in effect a sub-division of Fixed Assets, but include only such as decrease in value through the operation of being worked, and are therefore not subject to depreciation through wear and tear.

The question as to the value at which Wasting Assets should appear in the Balance Sheet is particularly important as affecting Limited Companies, and involves legal considerations. The subject is fully treated in Chapter X.

From a general point of view, it may be remarked here that in order to replace the exhausted capital out of revenue it is necessary to reduce the value of the Wasting Asset in the Balance Sheet to the extent of the estimated amount by which it has diminished in value.

Owing, however, to the difficulty experienced in many cases of ascertaining the loss occasioned by the wasting of the asset, it is common to find that provision is made therefor by way of General Reserve, the asset remaining in the Balance Sheet at its original value.

§ 6.—Depreciation.

(a) General Considerations.

One of the most important points which an Auditor has to consider is whether sufficient provision has been made for depreciation.

Depreciation may be defined as the shrinkage in value of an asset from any cause during a given period. If an asset has been acquired for the purpose of being utilised to earn income, and in the course of such process the value becomes gradually diminished, such decrease in value is a loss which should be set off against the income derived from working the asset, before the balance of divisible profit can be ascertained. If this is not done the Profit and Loss Account will not show the correct profit for the period, and the Balance Sheet cannot be said to represent the true and correct view of the state of the affairs of the business, inasmuch as the assets will remain at their original value, notwithstanding the fact that depreciation has taken place.

Where objection is taken by clients to the proper provision for depreciation, and the Auditor advances theoretical arguments in support of his view, these do not always receive sufficient consideration, owing to the fact that the practical bearing of the question of Depreciation upon the financial position of the business is not sufficiently emphasised. It cannot be too strongly pointed out that if the whole of the profits of a business are withdrawn without providing for the loss arising through depreciation, no moneys will be accumulated out of revenue during the life of the asset for the purpose of replacement. When such replacement becomes necessary, fresh capital will have to be provided for the purpose. Many cases have arisen

where, owing to depreciation having been ignored, businesses have been obliged to go into liquidation on the exhaustion of their capital assets, solely through the impossibility of raising fresh capital for the purpose of renewal.

In this connection it may be remarked that where large sums will be required at some subsequent period for renewal of assets, it is advisable that the moneys provided out of revenue for replacements should be invested outside the business, in order that they may be readily available. If the amount so set aside is left in the business, it will in due course form part of the working capital, and may be locked up in stock or other assets which may not be capable of ready realisation when it is necessary for the replacement to be made.

Before the Auditor can satisfy himself that the provision made for depreciation is adequate, he must have some knowledge of the considerations which are necessary to determine the rate of depreciation in connection with any particular class of asset.

Depreciation may be said to arise from two causes—Internal and External. Internal Depreciation is that arising from the operation of any cause natural to, or inherent in, the asset itself, *e.g.* wear and tear in the case of Plant and Machinery. External Depreciation is that arising from the operation of forces outside the asset itself, *e.g.* obsolescence in the case of Plant; effluxion of time in the case of a Lease.

In order to fix the rate of depreciation, the average life of the asset must be determined, and before this can be done the various forms of depreciation to which it may be subject should be considered. It is usually possible, given some knowledge and experience of the

business concerned, to estimate the rate of Internal depreciation, such as wear and tear, with reasonable accuracy. The loss occasioned by effluxion of time can be calculated exactly, but other forms of External depreciation are often so variable that the amount cannot be estimated accurately, and consequently provision is not usually made until the actual loss occasioned thereby has arisen.

The term Depreciation is usually understood to convey permanent shrinkage in value. Temporary shrinkage in value has been termed Fluctuation.

Where the Auditor is of opinion that insufficient provision has been made for depreciation, and he is unable to induce his clients to adopt his point of view, he must deal with the matter in his Report. The contention is frequently made that depreciation is an appropriation of profits, and not a charge thereon, and that consequently if no profits have been made, or a loss on trading has been incurred, no provision for depreciation can be made. The fallacy of this argument is apparent when it is seen that depreciation is a fact which exists, irrespective of the results of the business, and as such should be recorded in the books of account.

In considering the basis of depreciation, it should be remembered that in the course of years, conditions may materially alter, and thus affect the accuracy of the original calculations. It is therefore advisable that the rates should be reconsidered from time to time.

(b) The principal methods of providing for Depreciation as affecting different classes of Assets.

The following are the principal methods of providing for depreciation, where it is desired that the

amount set aside should be accumulated in the business :

The Fixed Instalment System, or "*Straight Line*" method whereby a fixed rate per cent. on the original cost of the asset is written off each year, so as to reduce the asset to nil or break-up value at the end of its life, repairs and small renewals being charged to Revenue.

The Reducing Instalment System, whereby a fixed rate per cent. on the diminishing value of the asset is written off each year, so as to reduce the asset to break up value at the end of its life, repairs and small renewals being charged to Revenue.

The Annuity System, whereby the asset is regarded as earning a certain rate of interest, and such fixed amount is written off each year as, after debiting the Asset Account with interest at the fixed rate per cent. upon the diminishing value, will reduce the asset to nil at the end of its life.

Where it is desirable to accumulate moneys outside the business, the following are the principal methods utilised. —

The Depreciation Fund System, whereby an equal amount is debited to the Profit and Loss Account each year, and credited to a Depreciation Fund Account, and an equivalent amount of cash is invested outside the business in gilt-edged securities, and allowed to accumulate at compound interest, so as to produce the required amount on the completion of a given number of years.

The Insurance Policy System, whereby an Endowment Policy is taken out for the life of the asset, so as to produce the amount required at the end of the particular period.

In cases where the nature of the asset renders it

difficult to provide for depreciation on a mathematical basis, *Revaluation* should be resorted to.

These various methods are fully dealt with and illustrated by means of examples in Chapter IV. of the Authors' volume on *Book-keeping and Accounts*, and it is now proposed to discuss the application thereof as affecting different classes of assets.

(1) *Freehold Land.*

It has been said that Freehold Land does not depreciate, but it is subject to considerable fluctuation in value, which may be either of a temporary or permanent character. If the land has permanently fallen in value below cost, depreciation has taken place. It is, however, not usual to make provision for such loss, or to record it in the accounts, until the property is realised.

(2) *Freehold Buildings.*

The amount of depreciation which should be provided in respect of Freehold Buildings will depend on the age of the buildings, and the nature of the business for which they are utilised. Repairs should in all cases be charged to revenue, and where the property is maintained in a good state of repair, the period of its life will be materially extended. If the building is an old one, it may become at some future time necessary to rebuild. Apart from this consideration, under normal circumstances the rate of depreciation should be taken at from one to three per cent. per annum, calculated on the cost, and it is advisable that the method adopted should be either the Sinking Fund or the Insurance Policy system, since in this way moneys will be readily available for rebuilding purposes.

Otherwise the Annuity system should be used, since, in the case of an asset possessing a long life, the question of the adjustment of interest becomes important, owing to the fact that the moneys representing depreciation are left in the business.

Generally the item Freehold Land and Buildings is shown in one sum, and the values attaching to the Land and Buildings respectively are not differentiated. In such cases the value of the Buildings for the purpose of depreciation must be estimated.

(3) *Leasehold Land and Buildings.*

Where Leasehold Land is bought and Buildings are erected thereon, provision should be made to replace the cost of the Land and Buildings at the expiration of the lease, and should additional buildings be erected, further provision must be made in respect thereof.

The premium paid for the acquisition of the lease may be regarded as a capitalisation of the difference between the outgoings payable under the lease in the shape of Ground Rent, &c., and the annual value of the property. If, therefore, only the actual outgoings are charged against the Profit and Loss Account, the business will not be debited with the actual rental value of the premises occupied. The depreciation of Leasehold property, therefore, may be regarded as a form of rent.

Where the value of the Lease is small, and the term unexpired does not exceed, say, seven years, the simplest method of providing depreciation is by the Fixed Instalment system. Where the Lease is a longer one, but it is not regarded as essential that the amount set aside should be invested outside the business, the Annuity system should be adopted. Under this system

the operation of charging interest on the diminishing value of the asset has the effect of increasing the net charge to revenue each year, to the extent of interest on the net amount set aside and accumulated in the business. The amount so set aside will be utilised as working capital, and should be the means of earning additional profit.

Where the value of the Leasehold property is considerable, and the cost of renewing the lease or acquiring fresh premises will be heavy, provision for depreciation should be made by the Depreciation Fund system, or by the method of taking out an Endowment Policy for the value of the lease.

Where the former system is adopted, the Auditor should check the calculations necessary to determine the annual amount to be set aside, and should see that the interest arising on the investments is regularly reinvested. Where the investments representing the Depreciation Fund have permanently depreciated in value, additional provision should be made to cover the loss occasioned thereby.

The system of taking out an Endowment Insurance Policy for the value of the lease is becoming increasingly popular, as it avoids the trouble involved in continually investing moneys, and if the Policy is taken out with a good Office, the precise amount required is ensured without any risk of loss on investments. The Auditor should see that an amount equivalent to the annual premiums is charged against Profit and Loss, and credited to the Redemption Account, the premiums paid being debited to a Policy Account, and treated as an asset. It is incorrect to charge the premium direct to Profit and Loss, as, although this has the same effect on the Profit and

Loss Account, the Policy will not appear in the Balance Sheet as an asset, nor will any Redemption Fund appear against the Lease.

The surrender value of such Policies is usually the total of the premiums paid, less the first premium, plus two per cent. per annum compound interest. In some cases the Policy Account is adjusted annually by debiting the interest accrued, and crediting the Redemption Account, for which purpose it is permissible to treat the first premium as an asset. The amount of interest so allowed for surrender value purposes is less than the rate of interest that will be realised when the Policy matures, and a profit will therefore ultimately appear on the Policy Account. Such profit should be transferred to the Redemption Account, which in that way will be brought up to the value of the lease, and can be utilised to write off the old Lease Account. In other cases no account is taken of the accruing interest, and consequently the profit on the termination of the Policy will be so much greater. In no event should the interest accrued be credited to Profit and Loss.

On the termination of a lease, a claim for dilapidations usually arises, and in some cases this involves a considerable sum. It is desirable that provision should be made to cover this liability during the life of the lease, and it is most convenient to do this by increasing the value of the lease by an estimated amount for dilapidations. This is sometimes done by deducting one or more years from the term of the lease; but where the lease is a long one, and the annual charge for depreciation consequently small, this may not be sufficient.

All repairs expended on the property during the

period of the lease should be charged to revenue, and where, owing to the age of the building, it may be necessary to rebuild before the termination of the lease, additional provision for depreciation should be made accordingly.

(4) *Fixed Plant and Machinery.*

Depreciation arises on Fixed Plant and Machinery by reason of wear and tear and obsolescence. The effect of wear and tear on the life of the asset should be capable of reasonable estimation, having regard to the state of repair in which it is maintained; machinery which is properly kept up lasting very much longer than where repairs are neglected. Repairs and small renewals should be charged to Revenue.

Theoretically, the most correct way of providing for depreciation on this asset is by the Fixed Instalment system or "Straight Line" method, since only by this method can the Plant be written down to nil at the expiration of its estimated life; and when this method is adopted a special book should be kept subsidiary to the Ledger Account, in which to record the details of all expenditure on the particular class of Plant and Machinery concerned. This will enable a record to be kept of each year's additions, upon which separate depreciation calculations will be necessary. The depreciation credited to the Asset Account in such a case will really consist of a number of separate depreciation calculations made in respect of the original purchase and of each year's additions until the same are individually written off.

So long as the plant is properly maintained out of revenue, there is no necessity to reduce the Plant Account to nil, since while the business continues as

a going concern, a considerable quantity of plant must always be in existence for purposes of production. It is, therefore, very usual to depreciate this asset on the Reducing Instalment system, additions being debited to the asset account, and a fixed rate written off the reducing balance. In fixing such rate, which generally may be said to vary from 5 to 12½ per cent., according to the estimated life of the asset, it must be remembered that a considerably higher rate should be taken than if the calculation were made on the Fixed Instalment system; *e.g.* on a Capital sum of £5,000, 5 per cent. per annum on the Fixed Instalment system will reduce the asset to nil at the end of 20 years; whereas on the Reducing Instalment system the balance left would be £1,792; while at 10 per cent. on the same system the balance left at the end of 20 years would be £608.

A further argument in favour of the utilisation of the Reducing Instalment system is that while the amount of depreciation tends to decrease, expenditure in the shape of repairs tends to increase, and consequently the annual total charge for maintenance is more regular; whereas under the Fixed Instalment system the amount of depreciation remains the same, although repairs tend to increase.

In estimating the average life of plant and machinery, an equated rate must be taken, as it is impossible to utilise separate rates in respect of each particular item of plant.

* Owing to the necessity of renewing the plant from time to time, there is generally no advantage in utilising the Depreciation Fund system, under which specific investment is made outside the business; but where the plant is of a heavy nature, which will require to be

renewed *in toto* at the end of a lengthy period, this system should be adopted ; and also in cases of Fixed Plant on Leasehold Works where the plant will pass with the Lease.

The risk of obsolescence is difficult to estimate for the purpose of depreciation, and frequently no account is taken thereof until the plant is actually superseded, when the loss may be written off over a period of years. In certain trades, such as the Electrical trade, the Motor trade, and others, where the possibility of obsolescence is considerable, allowance should be made therefor, and the rate of depreciation correspondingly increased ; but as it is not always possible to estimate this risk with any degree of certainty, the asset should be subjected to periodical valuation, and adjustment made accordingly.

Machinery purchased under a Hire-Purchase agreement, or an agreement to pay by instalments, should be depreciated on the original cash value of the machinery, and not on the actual instalments paid.

(5) *Loose Plant and Tools.*

Assets of this nature cannot be satisfactorily depreciated by way of a percentage, and the better method is by revaluation, especially in the case of Engineering concerns, where they may be made on the premises.

(6) *Furniture.*

Wear and tear of furniture should be provided for by depreciation on the Reducing Instalment system, at the rate of from 5 to 12½ per cent. per annum, according to circumstances, repairs being charged to Revenue, and renewals to the Asset Account.

(7) *Fixtures and Fittings.*

Depreciation on Fixtures and Fittings should be provided for in the same way as for Furniture, but where the Fixtures are on Leasehold premises, and pass to the Landlord, provision should be made on the same basis as for the Lease. In estimating the rate of depreciation, it should be remembered that whereas Furniture can be removed, and thus will always possess some value, any value attaching to Fixtures and Fittings is usually irrecoverable on removal from the premises.

(8) *Patents.*

Patents suffer depreciation from effluxion of time, since a Patent is only granted for a period of 14 years, though it may be subject to extension in certain cases. It is desirable, therefore, that the value of the Patent should be written off during its official life, although in many cases a residual value remains in the shape of Goodwill, built up during the continuance of the Patent. Sometimes the Master Patent is so protected by subsidiary Patents that the asset remains of considerable value.

Other causes of depreciation affecting Patents are obsolescence, the impracticability of working the Patent at a profit, or failure to induce the public to buy the patented article. It by no means follows, therefore, that a Patent remains of value during the whole of its life, and consequently revaluation in such cases should be resorted to. In no case should the value be written up, even though it prove to be much in excess of the cost price.

Fees incurred in taking out the Patent are of a capital nature, but renewal fees for maintaining the

Patent should be charged to Revenue, and not debited to the Patent Account.

It is preferable to adopt the Fixed Instalment system when it is desired to write off the whole cost of the Patent over a term of years.

(9) *Copyrights.*

Similar considerations apply to Copyrights as to Patents, except that the term of Copyright is considerably longer, being, with certain exceptions, the life of the Author and a period of fifty years after his death. As the vast majority of Copyrights do not retain any value during the greater part of their life, depreciation cannot be based on that period, and provision by way of revaluation of each Copyright is the only really satisfactory method. Further remarks on this subject will be found in Chapter V., § 7 (7) and Chapter XV., § 23.

(10) *Horses.*

Horses depreciate through age, and according to the manner in which they are worked. Any rate of depreciation that may be taken must necessarily be in the nature of an estimate, and it is preferable to work on a basis of revaluation. In any event revaluation should take place not less than once every five years.

(11) *Goodwill.*

The question is frequently discussed as to whether Goodwill suffers depreciation which requires to be dealt with in the same manner as depreciation on other Fixed Assets. There can be no doubt that the value of the Goodwill of a business may be less than the

price at which it was purchased, owing to alteration in trade conditions, or to different management. The value of the Goodwill is usually based on the average of the profits, and if the average profits are not maintained, such value must necessarily fall.

Goodwill, however, is by its very nature an intangible asset, and if the amount at which it stands in the books is shown separately on the Balance Sheet, it is apparent that a portion of the capital of the business is represented by this asset, which must be in any event of a hypothetical value.

Goodwill, therefore, is not consumed or exhausted in the process of earning income; it is not subject to wear and tear, or to obsolescence; it does not suffer depreciation as a necessary consequence of carrying on business; and it does not require to be renewed. Its value tends to increase when profits increase, and to fall when profits fall. At the period when it might be considered most desirable to write down the Goodwill, the profits earned may not admit of this treatment. When Goodwill is written down, it is written down in periods of good profits, and as a result a secret reserve may be formed.

So long, therefore, as the Goodwill is not written up, but remains in the Balance Sheet at cost, the Auditor need not concern himself with any fluctuation in its value.

§ 7.—Repairs and Renewals.

In discussing the question of depreciation, it has been stated that repairs and small renewals should in all cases be charged against revenue, and the Auditor

should ascertain whether this has been done. The distinction between small renewals which should be charged to revenue, and replacements which can be treated as additions to capital, provided the rate of depreciation has been sufficient, is sometimes difficult to define. It is advisable for the Auditor to examine all amounts debited to the asset account, and, by selecting certain items for enquiry, to satisfy himself that the treatment is a proper one.

The practice of debiting all expenditure on the asset, whether in the shape of Repairs, Renewals, or Replacements, to the asset account, and relying upon a heavier rate of depreciation to adjust matters, is very undesirable, since it tends to conceal the real cost of maintenance, and may easily result in expenditure being improperly capitalised.

Where the expenditure on Repairs is of a variable nature and considerable in amount, the estimated average charge under this heading should be debited to Revenue, and credited to a Maintenance Reserve Account, the actual repairs in each year being debited to the Maintenance Reserve Account, the balance of which should be carried forward, and separately stated in the Balance Sheet.

If such balance is a debit balance, there is no reason why it should not be carried forward, so long as it is likely to be recouped by subsequent instalments ; but the Auditor should satisfy himself on this point, since the fact of a debit balance being created may be due to the inadequacy of the annual charge, which in such cases should be increased. In any event the amount of the annual charge will require to be carefully watched, and adjusted from time to time.

§ 8.—Reserves.

Reserves may be of two classes—General and Specific.

A *General Reserve* is an amount set aside out of profits in order to provide additional working capital, or to strengthen the liquid resources, and to be available for contingencies.

A *Specific Reserve* is an amount set aside out of the profits to provide for some probable or estimated loss on the realisation of certain assets, or in respect of pending transactions.

(a) General Reserves.

It is not the duty of the Auditor to concern himself with the adequacy or otherwise of the amount placed to General Reserve, since this is a matter of financial policy. Frequently, however, he may be called upon to advise as to the amount that should be carried to Reserve, and as to whether it is preferable to retain it in the business, or to specifically invest it. Where additional working capital may be usefully and profitably employed in the business, it is sound financial policy to leave such profits in the business, since the amount so utilised will probably earn a far higher return than if it were invested in gilt-edged securities. Where, however, it is desired to reserve more than can be profitably utilised in the business, a specific investment in gilt-edged securities should be made, to the extent of the amount so set aside. In this manner realisable assets can be utilised at any moment, should there be a sudden call upon the business. A Reserve so invested is therefore a source of considerable strength. The fact, however, that the Reserve is not invested in this manner, but is retained in the business,

is not by any means a sign of weakness, since it may imply that the business is progressing, and consequently requires further working capital. At the same time the existence of such a Reserve depends entirely upon the values placed on the assets, and if such values are excessive, owing to the omission of proper provision for depreciation, or from other causes, the Reserve may only be a nominal one, or may be considerably smaller in fact than the figure at which it appears in the Balance Sheet.

Where a General Reserve is invested outside the business, it is called a Reserve Fund. This term is frequently applied where the Reserve is not represented by specific investments, but by the general assets of the business; and although the use of this phrase in this connection is to be deprecated (since the term Fund to most people implies some actual investment which can be realised at a moment's notice), opinion remains divided on the point. In order to avoid misconception, it is preferable to use the term Reserve Account rather than Reserve Fund, where the Reserve is not represented by specific investments outside the business. Further remarks on this subject will be found in Chapter IX., § 11.

(b) Specific Reserves.

A Specific Reserve is utilised where a loss is anticipated, but, the amount thereof being unascertained, it cannot be finally dealt with. As, however, the loss will have been incurred before the date of the Balance Sheet, the Profit and Loss Account should be debited accordingly, a Specific Reserve Account being credited.

Such Reserves may be made to provide for losses likely to be sustained on the realisation of certain

assets, or to provide for accruing liabilities, the precise amount of which is not known, and which will not result in the acquisition of corresponding assets.

Instances of the former class are Reserves for Bad Debts, Discounts, &c., and it is the Auditor's duty to satisfy himself that all estimated losses have either been written off or provided for in this manner.

The following are instances of Specific Reserves in respect of unascertained liabilities: Reserve against loss resulting from a fire not fully covered by insurance, Reserve against loss on Bills discounted likely to be dishonoured, Reserve against costs or damages under an action pending, Reserve against claims not admitted. Such Reserves are sometimes recorded under the heading of *Suspense Accounts*. The Auditor should ascertain that due provision has been made for all contingencies of this nature of which he is aware.

(1) *Reserve for Bad Debts.*

The question of Bad and Doubtful Debts from the Auditor's point of view has been fully dealt with in Chapter III. § 9 (d). Having ascertained in the manner there described what provision he considers should be made under this heading, the Auditor should check the Bad Debt Reserve Account in the Impersonal Ledger, and see that the necessary entries have been made.

Frequently the Bad Debt Account and the Bad Debt Reserve Account are combined, the actual Bad Debts written off being debited against the Reserve brought forward from the previous year, and a credit balance carried down equivalent to the extent of the new Reserve that is necessary. The difference on the account will then represent the amount necessary to

debit to Profit and Loss, being composed of the actual Bad Debts written off after the adjustment of the opening and closing Reserves, and so representing the full charge for Bad Debts for the year. It is sometimes preferred, however, to show the actual Bad Debts written off separately in the Profit and Loss Account, apart from the adjustment of the Reserve.

It has been pointed out that it is not the duty of the Auditor, as Auditor, to make the reserves he considers to be necessary, neither has he power to do so unless instructed by his client, in which case he acts in the capacity of Accountant. Where the reserves made are, in his opinion, insufficient, and he cannot persuade his client to increase them, he must deal with the matter in his Report.

(2) *Reserves for Discounts.*

The necessity for the provision of a Reserve against Cash Discount on Outstanding Debtors, and the anticipation of Cash Discount in respect of Outstanding Creditors, is a matter of opinion; but where the principle has once been adopted, the Auditor should see that it is continuously carried out. The argument in favour of the provision of such a reserve is that it is desirable that the book debts should appear in the Balance Sheet at the amount which it is expected they will ultimately realise, and that as the proportion upon which Cash Discount will probably be allowed can be ascertained from previous experience, the same should be taken into account.

The argument against the necessity for such provision is that as Cash Discount is an allowance made in consideration of the debtor paying his account within a given term of credit, the liability to allow

such discount is conditional, and does not accrue until the debtor pays. Moreover, as the discount is granted for the purpose of inducing the debtors to pay their accounts as soon as possible, it may be regarded as an expense attendant thereon. The more rapidly the debts can be realised, the less will be the working capital required, and the more frequently can that capital be turned over in the course of the trading period. From this point of view, therefore, it may very well be argued that the expense of Discount should be charged against the period which receives the use of the money.

The Auditor, therefore, can point out the desirability of providing such reserves, but they cannot be regarded as essential, and the omission to provide for them cannot be said to affect the accuracy of the Balance Sheet.

The amount of the provision necessary will be calculated either on each individual debt, or, more usually, by way of percentage on the outstanding debtors, the rate of which will be based on the discount allowed in relation to the turnover of previous years.

The anticipation of discount in respect of outstanding creditors should not be permitted, unless reserve is made against discount on outstanding debtors. Similar principles will apply as to its calculation.

(3) *Reserve for Depreciation of Investments.*

Where a considerable number of Investments are held, and the market value thereof at the date of the Balance Sheet is less than the book value, it may be advisable to provide for the depreciation that has

occurred. The most convenient method of doing this is to create an Investment Reserve Account, by debiting Profit and Loss Account, and crediting a Reserve Account with the difference between the total market value of the Investments and their book value.

If this method is adopted, it will be unnecessary to adjust the value of each investment on the occasion of each Balance Sheet, the Reserve Account being adjusted from time to time according to circumstances. In the event of any loss arising on realisation, this will be debited to the Reserve Account instead of to Profit and Loss Account. In the Balance Sheet the Reserve Account should be deducted from the Investments.

(4) *Insurance Reserves.*

It is customary in some businesses, where the amount of Insurance is considerable, for a portion of the risk to be taken by the business, either in respect of Fire, Marine, or Employers' Liability. Where this is done an amount equivalent to the premium which would have been paid, had the insurance been effected outside, should be credited to an Insurance Reserve Account, which should be allowed to accumulate, any losses arising thereunder being debited thereto. Strictly speaking, such accumulated premiums should be invested outside the business, so as to be easily available in the event of loss arising, and in such cases the Insurance Reserve Account is termed an Insurance Fund, and will be represented by investments on the other side of the Balance Sheet. Where, however, transactions of this nature are not numerous, and the amount of the accumulated premiums is insignificant, specific investment thereof is not usually made.

The Auditor should ascertain that proper provision has been made under this heading, and that no profit is taken in respect of such transactions until the amount of the accumulated premiums is considerably more than is sufficient to cover any probable loss.

This subject more particularly affects Shipping Companies, and will be discussed more fully in Chapter XV., § 28.

§ 9.—Contingent Liabilities.

The Auditor should ascertain whether there are any transactions outstanding at the date of the Balance Sheet which may involve the payment of moneys at some subsequent date. Such outstandings are termed "Contingent Liabilities," and may be of two classes: in the one case involving a loss should the liability accrue, and in the other case involving the acquisition of an asset or corresponding value.

Where, in the event of the liability accruing, loss would be incurred, the amount of the contingent liability should be stated on the face of the Balance Sheet by way of a note, and where necessary reserve should be made accordingly. The most familiar instance is Contingent Liability on Bills Receivable discounted. If at the date of the Balance Sheet any of the bills that have been discounted are outstanding, there will be a contingent liability in respect thereof, since if the acceptors do not meet the bills at maturity, the holders will have a right of recourse against the drawer or any prior endorser. As it may not be known at the date of the Balance Sheet whether all these bills will be met, a note should be inserted stating that there is a contingent liability in respect of bills

under discount amounting to £ (the face value of the bills). Where it is anticipated that any bill will be dishonoured, and that a loss will be subsequently incurred, provision should be made accordingly. In many cases, by the time the Audit is completed several of the bills will have matured, and it will be only in respect of those outstanding that the Auditor should consider the advisability of reserve being made.

Other instances of Contingent Liabilities which might involve a loss, should they accrue, would be damages and costs in the case of an action pending, forward contracts, guarantees for third parties, and speculative transactions open on the Stock Exchange. The last-mentioned will be considered in Chapter XV., § 34.

In many cases where, should a liability accrue, it will involve the acquisition of a corresponding asset, it is usual to make no mention of it upon the Balance Sheet. Instances of this are contingent liabilities under trade contracts, or under agreements for service, or for the erection of plant or buildings, though where the amount involved is considerable it is advisable to note it. The contingent liability in respect of shares partly called up, held by way of investment, should be disclosed.

SYNOPSIS OF CHAPTER V.

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CHAPTER V.

THE VERIFICATION OF ASSETS.

§ 1.—General Considerations.

The most important duty of the Auditor, apart from his examination of the books of account, is the verification of the assets appearing in the Balance Sheet. If the transactions have been correctly recorded in the books, evidence will appear therein of all the assets that have been acquired in the course of business; but it is not sufficient for the Auditor to verify the correctness of the Balance Sheet as shown by the books— he must go further, and verify, by actual inspection or otherwise, the existence of the assets. The fact that there is an entry in the books recording the asset does not prove that the asset itself exists, even though the Auditor may have vouched the accuracy of the entry. The entry only goes to prove that the asset ought to exist, and it is the duty of the Auditor to satisfy himself that the asset actually does exist; and if his inspection or examination of evidence takes place after the date of the Balance Sheet, he must satisfy himself that the asset existed at the date of the Balance Sheet.

In the case, however, of those assets which continually change in the ordinary course of business,

such as Cash, Bills Receivable, and, in some cases, Investments, an inspection should be made either at the close of business on the day of the Balance Sheet or as soon thereafter as possible. If transactions have occurred subsequent to the date of the Balance Sheet, and prior to the date of examination, these must be vouched, in order to prove the existence of the asset at the date of the Balance Sheet. Where dealings are numerous, and delay has taken place, the difficulty of verifying in this manner is considerable.

One of the commonest forms of fraud is the misappropriation of cash or other assets of an easily negotiable character, and in verifying such assets the Auditor should take every precaution in order that he may not be deceived by any substitution of assets : *e.g.* where there are several cash balances, the Auditor should call for the production of all these at the same time, since, if he examines them on different days, a portion of one balance may be utilised to make good a deficiency in another. In a similar manner, where there are a large number of investments, care must be taken to see that they are all produced at the same time. It must be remembered that it is possible for negotiable assets to be fraudulently pledged. Unless, therefore, proper precautions are taken, the assets that have already been verified by the Auditor may be utilised to free those that have been pledged, which, being thus released for the Auditor's inspection, could be returned to the pledgee immediately afterwards. For this reason the Auditor must take such precautions as will enable him to satisfy himself that all the assets he examines are free from any charge upon them which is not in order, and recorded in the books of the business.

Another form of fraud, which the verification of assets serves to guard against, is the improper inflation of values, or the creation in the books of the record of an asset which does not exist, or which in fact never has existed. The object of this form of manipulation is in most cases to increase the profits, and correspondingly to increase the assets, thus making the position of the business, as shown by the Balance Sheet, appear stronger than it actually is. A common instance of this is the inflation of stock-in-trade, either by over-valuation or by the inclusion of fictitious items.

The verification of assets, therefore, should include not only the verification of the existence of the asset, but also of the value at which it appears in the books, as far as it is possible for the Auditor to satisfy himself of this.

Misappropriation of assets, inflation of profits, and falsification of the Balance Sheet, may not be detected by the Auditor if he is negligent in the performance of his duties in this connection, and he may find himself liable for heavy damages in consequence.

Documents of title deposited with Bankers, Solicitors and others for safe custody, or for the purpose of reference or sale, should be actually inspected by the Auditor where possible. If this cannot be done, he should obtain a certificate from the holder, stating that the assets are held free from charge; and where he relies upon such certificate, he should state in his Report that he has done so.

The verification of the different classes of assets common to most Balance Sheets will now be considered. Assets of a special nature affecting particular businesses will be dealt with in Chapter XV. devoted to the Audits of different undertakings.

§ 2.—Land and Buildings.

(a) Freehold Property.

The Title Deeds should be examined by the Auditor. He cannot, however, make himself responsible for the validity of the title; nor should he attempt to verify it. That is the duty of the Solicitor, and it is sufficient if the Auditor ascertains that the Title Deeds appear to be genuine, and in order; that they refer to the property, the existence of which he desires to verify, and that the sequence of the various deeds composing the title appears to be complete. He should examine the last deed, and see that the property is duly conveyed to his clients or their Trustees.

If the property has been mortgaged, the Title Deeds will be in the possession of the Mortgagee or the Solicitor, and a certificate should be obtained to that effect.

In the case of Freehold Ground Rents, Title Deeds and counterparts of Leases should be examined by the Auditor, and it should be seen that the last Ground Rent has been duly received.

If the land has been registered under the Land Transfer Acts, a land certificate will be issued, which the Auditor should inspect. This certificate states that the land described therein is registered with an absolute, qualified, good, leasehold, or possessory title (as the case may be). It may be in the possession of the owner of the property, or may be deposited at the Land Registry. New certificates are not made out on the transfer of registered land, but a note of the transfer is indorsed upon the certificate. Except in special cases, all documents of title are retained at the Registry.

Subject to any depreciation that may be necessary in respect of buildings, the Freehold Property should appear in the Balance Sheet at cost. It is not desirable to write up the item, even though the actual value of the land may have increased, but where this course is followed, the method adopted must be clearly shown in the accounts. On the other hand, it is not usual to take account of any fall in the market value until realisation, when the loss can be accurately ascertained.

(b) Leasehold Property.

The Lease should be inspected, and the Auditor should ascertain that all conditions, the non-fulfilment of which might involve forfeiture of the Lease, have been duly complied with, such as prompt payment of Ground Rent, maintenance of Fire Insurance, Covenants as to Repairs, &c. Similar considerations as to value apply as in the case of Freehold Property.

Where Leasehold Property has been sub-let, the counterpart of the tenant's agreement should also be examined.

It should be seen that proper provision has been made for depreciation of Leases.

(c) Copyhold Property.

In the case of Copyhold Property, there are no Title Deeds, and a certified copy of the Court Roll of the Lord of the Manor should be examined.

§ 3.—Investments.

Where investments are numerous, the Auditor should have produced to him a Schedule of the Investments, showing the full title of each Stock, the book value, and the market value as at the date of the Balance Sheet.

The whole of the Investments should be produced at the same time, and where they stand in the name of individuals, as held in trust for a Company or Corporation, a Deed of Trust should be produced. Where no such deed is in existence, the Auditor should obtain a letter from the parties, stating that they hold on behalf of the Company, free from any charge, and he should advise that a Deed of Trust be entered into. In all cases the Auditor should see that the particulars of the Investments correspond with those entered on the Schedule, especially where different classes of Stock or Shares are issued by the same Company.

(a) Registered Stocks and Shares. /

The term "Registered" implies that the name of the holder has been entered in the Register of the Company, and that a certificate has been issued in his name. The certificate will be examined, and the Auditor should see that it appears to be properly executed and sealed.

Where Registered Stock has been sold prior to the date of the Balance Sheet, but delivery has not been effected at the date of the Balance Sheet, the certificate will not have been handed over, and should be produced, together with the Broker's Sold Note, or if the certificate has been sent to the Broker his receipt should be seen. If delivery has been effected, it should be seen that the proceeds of sale have been duly received.

Where part of a holding has been sold, and the certificate for the total holding has been delivered but no new certificate has yet been issued, the Auditor should call for the Balance Certificate, which is an interim certificate, issued for the balance of the shares held, until the new certificate can be prepared. Some

Companies do not issue these Balance Certificates, but will certify the balance if called upon to do so. In other cases the transfer is endorsed on the back of the original Certificate.

Where shares have been purchased and the Transfer Deed lodged with the Company for the purpose of registration, but the new certificate has not been issued at the date of the Audit, the Auditor should ask to see the Transfer Receipt. This will state that a transfer has been lodged, transferring certain shares from one party to another, and will be sufficient evidence of ownership. These Transfer Receipts are not always issued, but can be obtained if required.

In the case of many American concerns, certificates are issued the title in which passes by delivery and indorsement on the back. Where the purchaser desires to be registered, his name must be inserted on the indorsement as Transferee, and a new certificate will be issued to him on delivery of the old certificate properly indorsed. Where, however, it is not anticipated that the stock will be held for any length of time, it is not usual to fill in the name of the Transferee, or to obtain a new certificate, and the old certificate indorsed by the Transferor in blank will be sufficient evidence, if the name is a good market name or the signature is guaranteed, though it should be remembered that in this way the document of title becomes a bearer document until the name of the Transferee is filled in.

Some forms of British Government Securities may be registered as mentioned below.

(b) Inscribed Stocks.

No certificate is issued to the holder of this class of stock, but his name is inscribed in the Register of the Stock kept at the place of inscription, which will

usually be either the Bank of England, the London County and Westminster Bank, Lothbury, or the Crown Agents for the Colonies. British Government Stocks, such as Consols, War Loans, War Bonds, Annuities, Local Loans, &c., may be inscribed in this manner; also India 3 and $3\frac{1}{2}$ per cent. Stocks, a large number of Colonial Issues, London County Council Stocks, and many Municipal Issues.

At the time of purchase of Inscribed Stock a Stock Receipt is issued, setting forth the nominal amount purchased and the consideration, but this receipt does not require to be delivered on the sale of the stock, and consequently possesses no value as a document of title. In order to verify the existence of stock at the date of the Balance Sheet, a form of certificate should be obtained from the Bank of England, or other place of Inscription, which should be filled up with particulars of the Stock, and the names of the persons to whom it is inscribed, and sent to the Bank for verification. If in order, the certificate will be returned duly signed on behalf of the Bank, and is evidence that so much stock was held on the day in question; but this certificate does not require to be delivered on sale, and consequently a fresh certificate must be obtained on the occasion of each Audit. The application for the certificate must be signed by one of the stock holders, and a fee of 6d. on each stock, with a minimum fee of 1s., must be paid, except in certain cases. The certificate will be sent direct to the Auditor, if instructions are so given, and it is advisable that this should be done, in order to prevent the possibility of any alteration in the figures. The Bank should also be asked to furnish a letter stating that no *distringas* or other restraint is recorded against the Stocks in question.

(c) British Government Securities.

The vast amount of Government borrowings arising in consequence of the War, and the fact that practically every business concern holds Securities of this nature in one form or another which have to be verified by the Auditor, render it desirable to mention the principal types of Securities.

- (1) $2\frac{1}{2}$ per cent. Consols. This was the principal Government Security before the war, but a large portion of the Issue has now been converted into various War Loans.
- (2) $3\frac{1}{2}$ per cent. 1925-28 and $4\frac{1}{2}$ per cent. 1925-45 War Loans, are, like Consols, either inscribed at the Bank of England or issued in the form of Bearer Bonds.
- (3) 5 per cent. War Loan, 1929-47 may either be inscribed at the Bank of England, transferable by Deed, or take the form of Bearer Bonds, and the same remarks apply to the 4 per cent. War Loan 1929-45. In the case of the 5 per cent. Loan, the Interest is paid after deduction of Tax whether the Stock is inscribed or registered. The Tax is deducted where the Stock is in the form of Bearer Bonds. The 4 per cent. Loan is issued free and no Tax is payable on the Interest arising thereon.
- (4) *Exchequer Bonds* were issued for considerable amounts in the earlier years of the war at rates varying from 3 per cent. to 6 per cent. The earlier series were in the form of Bearer Bonds, but the later ones can also be registered, and in that case the interest is payable without deduction of Tax.
- (5) *National War Bonds*.—The issue of National War Bonds was an experiment in continuous

borrowing, which proved an enormous success. They are either 5 per cent. Bonds subject to Tax, or 4 per cent. free of Tax. The Interest on the registered 5 per cent. Bonds is paid without deduction of Tax. The Bonds are redeemable at a premium.

- (6) *Treasury Bills*. The issue of Treasury Bills was the principal method by which floating indebtedness was met throughout the war. These Bills were issued for three, six or twelve months either by tender or at fixed rates. No Interest is payable on the Bills, but they are issued at a discount, the difference in the price payable for the Bill and the nominal amount thereof, representing the Interest. The documents are Bearer documents.

Except in the case of the 4 per cent. War Loan and the War Bonds issued free of Tax, Tax is payable in respect of Registered or inscribed Securities as above-mentioned, notwithstanding the fact that the Interest is paid gross in the first instance. The taxpayer is obliged to return the amount received in the year proceeding the year of assessment, and similarly in the case of the discount on Treasury Bills. Where Interest in this way is received gross, the Auditor should see that provision for Income Tax is made in the Accounts.

(d) Bonds to Bearer, and other Securities.

The Bonds should be examined, and it should be seen that the coupons for the next payment of interest are attached, as otherwise the Bonds are not good delivery.

In the case of Share Warrants to Bearer, where the dividends are not payable at fixed dates coupons for dividends will not bear any printed date.

Where Stock has only recently been issued, and all the Instalments or Calls have not been paid, Defini-

tive Certificates or Bonds will not as a rule be seen. The document of title will then consist of the Letter of Allotment, with Bankers' Receipts attached for the sums paid on application and allotment, calls, or instalments. Where Interim Certificates or Bonds have been issued, and the stock is only partly paid, the voucher for calls or instalments subsequently paid will usually take the form of indorsement on the document, which will continue to be held as evidence of title until it is ultimately exchanged for a definitive certificate or bond.

(e) Verification of Values.

Investments should appear in the Balance Sheet at cost, and brokers' bought notes will be sufficient evidence of the price paid. The necessity or advisability of providing for depreciation can only be considered in relation to the present value of the Investments, and the Auditor should therefore ascertain this as far as he is able to do so.

In the case of stocks and shares quoted on the Stock Exchange, the Official List published at the date of the Balance Sheet should be consulted. Stocks and shares not officially quoted may nevertheless be quoted by financial papers, and if so, such quotation should be referred to.

Where no quotation exists, considerable difficulty is sometimes experienced in arriving at a fair estimate of the value. Inquiries can be made of the Secretary of the Company concerned, as to the recent prices at which shares have been transferred; but this is not necessarily a true criterion of the value, inasmuch as where no free market exists the purchase consideration does not always represent the actual value. In any

case, such information is not sufficient, and the Auditor should ascertain what dividends have been paid recently on the shares, and if he is able to inspect a copy of the last Balance Sheet of the Company concerned, he will then have some material upon which to form an opinion.

Investments should not be written up except in special circumstances as in the case of Stock Exchange Accounts or changes in a Partnership; but on a revaluation of all the Investments a rise in the value of some may be set off against a fall in the value of others.

§ 4.—Stock-in-Trade.

As the correctness of the profits of a trading concern depends, to a large extent, on the accuracy of the valuation of the stock-in-trade at the date of the Balance Sheet, the verification of this asset forms an important part of the Auditor's duties. At the same time such verification is attended by many more difficulties than in the case of other assets, inasmuch as no entries will usually appear in the financial books, showing what stock-in-trade should be in hand. Where accurate stock records are kept, evidence is available which will materially assist the Auditor to satisfy himself as to the correctness of the stock, but in the great majority of businesses such detailed accounts are not practicable. The Auditor cannot be expected to verify the existence of the stock by actual inspection, nor is it his duty to do so. He is not a valuer, and the technical knowledge of the trade concerned, which he may or may not possess, will not as a rule be sufficient to enable him to form an opinion as to the correct valuation of the stock. He is usually unable, therefore,

to verify the existence of this asset, either by reference to the financial books or by actual inspection, and he cannot assure himself of the accuracy of its value by the methods which are available in the case of other assets, such as Investments. Accordingly the verification of this asset must be performed by testing the accuracy of the stock sheets submitted to the Auditor.

(a) Method of Stock-taking.

Stock should be taken immediately after the close of the last day of the period, one person calling out the quantities and description of the goods, and another entering them on the Stock Sheets. The particulars so ascertained having been checked by two other clerks, a responsible official should enter the price at which each item of stock is to be taken. These will be extended by one clerk, and the calculations and casts checked by another. Each person should initial for the work he has performed, and the whole should be certified by a Chief Manager, Partner, or Director.

Care should be taken to see that all goods not on the premises, but which form part of the stock of the business, and in respect of which invoices have been passed through, are included. Instances of this class are Stock in Transit, by land or water; at the Docks; in the hands of Agents or Customers; or at Branches.

On the other hand, no item should be taken into stock in respect of which invoices have not yet been passed through the books, unless the property therein resides in the purchaser at the date of the Balance Sheet, when it should be seen that the corresponding liability is also included. It should be ascertained that no goods are taken into stock which have been sold and treated as Sales, but not yet delivered to the

customers, and in the same way no goods held on behalf of third parties, by way of consignment or agency, should be included.

Unless great care is exercised, errors are certain to arise in connection with stock-taking. In many cases the people employed to take stock are not connected with the book-keeping, and do not understand the distinction between one class of stock and another, or realise how seriously errors of this nature may affect the accounts. Consequently, active and efficient supervision on the part of some responsible official is essential.

(b) Basis of Valuation.

Stock should be valued at cost or market price, whichever is lower at the date of the Balance Sheet. In no case should the value be higher than cost, even though the market value has risen, as this would result in taking profit before the sale is effected and the profit earned. On the other hand, a fall in the market value, due to a fluctuation in the price, need not be considered if the value has since risen. A permanent fall in value, however, must be taken into account.

Stock is a floating asset, and as such must be brought into account at its realisable value, when that value is lower than cost. It is bought for the purpose of selling again at a profit, and if at the date of the Balance Sheet it cannot be sold at a profit, a loss has already been sustained, which must be provided for by bringing such stock into account at a reduced value. This operation is known as "writing down," and must also be effected in cases where stock has become obsolete or spoilt.

Manufacturing stocks can be divided into three classes—Raw Materials, Goods in course of manufacture, and Finished Goods.

(1) *Raw Materials.*

Raw materials should be valued at cost or under, the prices being obtained from the invoices or market quotations. If any duty, freight or charges have been paid, a proportionate rate to cover these should be added.

Where goods have been bought at various prices, and the stock cannot be distinguished as belonging to any one parcel, an average price should be taken, not however, in any event higher than the market price.

Where proper Stock Accounts have been kept, either in connection with a system of Cost Accounts or otherwise, the Stock of each class of material should be agreed with the Stock Accounts relating thereto. Differences will constantly be found to exist, owing to breakage of bulk, &c. ; but these should not exceed a certain percentage, which can be arrived at from experience. The cause of any material difference should be traced, as if the actual stock is less than that shown on the Stock Account, the difference may be due to irregularities. In any case the actual stock as taken should be brought into account, and the Stock Accounts must be adjusted accordingly.

(2) *Goods in course of Manufacture.*

Goods may be in course of manufacture, either for stock or in fulfilment of contracts. In either case the basis of valuation should be the same. The cost of the raw materials utilised and the proportion of wages expended upon the goods should be taken ; to which may be added a percentage to cover Establishment Charges relating to manufacture.

The term "Work in Progress" is generally utilised in connection with Contract Work not completed, and

this will be considered under the Audit of Contractors' Accounts in Chapter XV., § 10.

(3) *Finished Goods.*

The same principles apply to the valuation of Finished Goods as to the valuation of Goods in course of Manufacture, and where Cost Accounts are utilised, the Auditor should refer to these for the purpose of testing the prices.

The question as to what percentage may be taken as reasonable to cover Establishment Charges is one of considerable importance, and it is frequently found that a very liberal estimate is made under this heading. It is sometimes contended that the percentage for Establishment Charges should cover, not only actual manufacturing expenses, but also such items as Rent, Rates of Factory, Power and Light, Maintenance of Plant, Depreciation, Salaries of Managers, and sometimes even a charge to represent interest on capital employed at the Works; but however desirable it may be to take these factors into account for costing purposes, and in fixing the selling price of an article, it is undesirable to take too much account thereof in the valuation of stocks. Each case, however, must be considered on its merits, and no hard-and-fast rule can be laid down.

In no case should the value taken be in excess of the price at which similar stock could be purchased in the market. Sometimes during the early stages of a new business, or when a factory is not working at its normal capacity, the actual cost of production may be in excess of the market value of similar goods, and in such cases the stock should be valued at the lower price.

(4) Stores, &c.

Other classes of stocks may be on hand at the date of the Balance Sheet in addition to stock-in-trade proper, *e.g.* stores for the upkeep and maintenance of Plant and Machinery, Fuel, &c. Where these are of any consequence, it is desirable that a valuation thereof should be taken, in order that the amount charged against revenue may represent the actual quantity consumed during the period under review. In order to effect this, such stock should be brought down as a debit balance on the expenditure account to which it relates, and not included in the general total of stock-in-trade taken to the credit of the Trading Account.

(c) The Auditor's Duty in relation to Stock-in-trade.

The extent to which the Auditor is responsible for the value of the Stock-in-trade appearing in the Balance Sheet was considered in the case of the *Kingston Cotton Mill Co.* (No. 2, 1896, 1 Ch. 331), which will be fully discussed in Chapter XII., § 3. It may be remarked here that the Court held that an Auditor is not a valuer; that it is not his business to take stock; that in the absence of suspicious circumstances he is entitled to rely upon the representation of responsible officials; and that he is not guilty of negligence if he accepts the certificate of such persons as to the value of the Stock-in-trade.

The Auditor, however, should not confine himself to seeing that the stock is duly certified, but should in addition satisfy himself by testing the Stock-sheets. The work that should be performed in most cases may be summarised as follows:—

- (1) Ascertain methods of stock-taking, and the basis of valuation.
- (2) Cast the Stock-sheets.

- (3) Test some of the extensions.
- (4) Test some of the prices of the raw materials with invoices, and of goods partly and wholly manufactured with Cost Accounts, or whatever evidence may be available. Where necessary, test prices with market quotations.
- (5) Compare the Stock-sheets with those of the previous period for the purpose of noting any variation in the prices at which similar classes of stocks are taken; and observing whether old or obsolete stock is properly written down in value.
- (6) Where quantity stock accounts are kept, examine these to ascertain that the quantities taken into stock agree therewith, subject to any adjustments that may be necessary.
- (7) See that the stock is properly certified by some responsible official, as taken at or under cost, and that all clerks occupied in entering and checking the sheets have initialled for their portion of the work.
- (8) Compare the percentage of gross profit on turnover with that of previous periods. In the case of a business where the average rate of gross profit is fairly constant, this test is of considerable value as a check upon the correctness of the stock; since, if there is any increase or decrease in the rate of gross profit, which cannot be satisfactorily accounted for by a rise or fall in the cost of production, or the selling price, the cause of the difference will usually be due to errors in stock-taking, or to the improper inflation of values.

Such tests as the above, though not of themselves proving the correctness of the stock, will serve to

protect the Auditor against any charge of negligence, should errors or fraud afterwards be discovered. Where the Auditor is satisfied that the stock is correct, it is not usual for him to refer to the matter in his Report ; but where, owing to the nature of the business, or to the manner in which the stock has been taken, this is not the case, it is advisable for him to state in his Report that he has accepted the certificate of the officials, such statement being qualified, where necessary, according to the facts of the case.

Where stocks are in bonded warehouses, the warrants should be examined by the Auditor, and certificates should be obtained for all stocks in the hands of other parties. Documents of title to stock may be lodged with bankers or others as security for advances, and in that case the Auditor should obtain a certificate from such parties, and verify the amount of the loan so advanced.

§ 5. —Loans on Security.

*The verification of Loans on Security involves not only an examination of the Loan Account in the Ledger, but also of the security lodged, in order that the Auditor can satisfy himself that the loan is properly secured, and that there is a reasonable margin between the amount of the loan and the value of the security.

The fact that interest is regularly charged up and paid on the due dates, is additional evidence of the existence of the loan. Interest in arrear for any length of time may indicate that the account is doubtful, and where it is added to the amount of the debt, it should be seen that further security is lodged, if necessary.

When the Auditor does not consider the debt fully secured, and particularly in cases where the

interest is accumulating without further security being lodged, he should see that proper reserves are made to cover any possible loss. Where interest has not been paid, it is sometimes left out of account altogether. This prevents the possibility of such interest being credited to revenue, and distributed as profit, when it is never likely to be received. On the other hand, such treatment does not record the actual state of the Loan Account, and in the case of banks and other concerns whose business it is to advance money, it is usual to find the interest regularly charged up, the amount of such interest either being fully reserved for, or taken to the credit of an Interest Suspense Account, which is brought forward as a liability, and not treated as profit until the interest is actually received.

The nature of the security lodged against Loans varies with each class of business transaction. A Loan on the security of land, or any estate therein, is secured by way of a Mortgage, which may either be Legal, when the actual title in the land will be conveyed, or Equitable, which may be effected either by a written instrument termed a Memorandum of Deposit, or by the deposit of title deeds only.

Where the loan is secured by the transfer of possession of movable assets or by the deposit of securities, the transaction is called a Pledge.

The Auditor's duties in connection with the verification of the more usual classes of Loans on security will now be considered.

(a) Loans on Mortgage.

On the occasion of the first Audit, the Mortgage Deed conveying the property to the Mortgagee should

be examined in detail, the following points being noted :- -

- (1) The name of the party to whom the property is transferred. If a Company, the names of the Trustees or nominees will be inserted, and the Auditor should satisfy himself that they hold on behalf of the Company.
- (2) The particulars of the property transferred, which should correspond with the title deeds of such property.
- (3) The amount of the Loan, and date thereof.
- (4) Rate of interest payable.

The above details are usually indorsed on the back of the Mortgage, and if the Auditor has verified them on the first occasion, it will not be necessary for him to examine the deed in detail at subsequent Audits.

The Title Deeds deposited with the Mortgage Deed should be examined, the same considerations applying as in the case of verification of freehold and leasehold properties, referred to in § 2 of this Chapter.

The last receipt for Fire Insurance should be produced, in order that it may be seen that the property is protected against fire, and in the case of leaseholds the last receipt for ground rent.

In order to verify the value of the property, and to see that there is sufficient margin, the Auditor should inspect the valuer's certificate, and should see that the amount of the advance does not exceed two-thirds of such value. Where the loan has been outstanding some time, and there is any possibility that the value of the property has diminished, a further valuation should be made.

In the case of a second Mortgage, the Mortgage Deed should be examined, and should recite the prior charge. The Title Deeds will be in the possession of the first Mortgagee, and the Auditor will therefore not be able to inspect them, but an acknowledgment should be obtained from the first Mortgagee or his Solicitors, stating that he has received notice of the second charge.

Where, as in the case of Building Societies, there are a large number of Mortgage Deeds, special considerations apply, which are dealt with in Chapter XV., § 5.

(b) Loans on Investments.

The Auditor should examine the Schedule of Investments deposited as security for the Loan, and verify the investments in the same manner as already described in § 3.

In so far as the securities deposited are to Bearer, no question will arise as to transfer of the title, but in the case of registered or inscribed stocks, the Auditor should see that the stocks have been actually transferred into the name of the lender or his nominee.

The deposit of the certificate issued to the borrower, accompanied by a blank transfer signed by him, which is not completed and registered immediately, though it may constitute an equitable charge, will not of itself afford a complete security. This subject is fully considered in Chapter IX., § 2 (g).

The values of the securities deposited should be tested by the Auditor in the manner previously indicated, in order that he may ascertain whether there is sufficient margin to fully secure the loan; and he should ascertain that the usual undertakings have been lodged to repay on demand, or at a fixed date with interest, or to deposit further security in the event of that held

depreciating by reason of a fall in market values during continuance of the loan.

(c) Loans on other Security.

Goods are frequently pledged for advances. Where the goods are in transit, the complete set of Bills of Lading, duly endorsed in favour of the lender, will be deposited, together with the Insurance Policy. Where the goods are at the Docks, or in bonded or other warehouses, the dock warrants or warehouse certificates, endorsed in favour of the lender, will be lodged. Where warrants or certificates have not been issued, Delivery Orders in favour of the lender will be lodged. Delivery, however, will not be made on such orders until all the rent and other charges accrued on the goods have been paid; and the extent of any liability outstanding in this respect should be ascertained, as it may materially affect the value of the security. The Auditor should test the value of the goods by reference to market quotations, invoices, &c.

In order to verify loans on personal guarantees, the guarantee should be seen. Under the Statute of Frauds it is necessary that this should be in writing and duly stamped. In order to ascertain whether the loan is secured, the Auditor must satisfy himself that the guarantor is good.

Loans on the security of Life Policies, though they may be fully secured in the event of the immediate death of the Assured, should only be regarded as secured to the extent of the surrender value of the Policies. The Auditor should require the production of a statement from the Insurance Company, showing the surrender value, and ascertain that due notice of

assignment has been given to the Company. The last receipt for premium should be inspected.

A loan on the security of a Bill of Sale will be verified by inspection of that document. It should be seen that the Bill has been duly registered, and that all the requirements of the Bills of Sale Act, 1882, have been complied with.

§ 6.—Bills Receivable.

The balance of the Bills Receivable Account in the Impersonal Ledger will represent bills in hand at the date of the Balance Sheet, and if the Auditor attends on that date he should inspect the actual bills. In most cases, however, the verification will take place after the date in question, and consequently, the bills that have been met subsequently will be verified by vouching the cash received. In the case of bills discounted since the date of the Balance Sheet, the receipt of the proceeds will be verified.

In examining the bills the Auditor should see that they are properly drawn and stamped, and that they are not overdue. Where there is any doubt as to whether the bills will be met, inquiries should be made, and it should be seen that sufficient reserve has been made if a loss is likely to be sustained. Where a bill has been retired since the date of the Balance Sheet, the new bill should be seen; and where part of the original bill has been paid, it should be seen that the proceeds have been received, and that a new bill has been obtained for the balance.

Where transactions in bills are numerous, it is usual to place the bills in the hands of bankers or other agents for collection, when a Bills Collection Ledger will generally be found, containing accounts with each

bank or other party to whom bills are handed for collection, the Bills Receivable Account being credited and such parties being debited. The balances on such accounts will represent bills in the hands of those parties at the date of the Balance Sheet, and certificates should be obtained from them detailing the bills held at that date. The examination of such certificates by the Auditor will be sufficient verification.

The Auditor should see that a note of the contingent liability in respect of bills discounted outstanding appears on the Balance Sheet, and that proper reserve has been made in respect thereof if necessary.

§ 7.—Other Assets.

(1) *Book Debts.*

The verification of book debts has already been dealt with at length in Chapter III., § 9 (c).

(2) *Cash at Bank and in Hand.*

The verification of Cash in Hand and at Bank on Current or Deposit Account, and of the Petty Cash balance, has been dealt with in Chapter II., §§ 6 and 7.

(3) *Endowment Policies.*

Endowment Policies taken out for the redemption of Leases, or Sinking Fund Policies for the redemption of Debentures, and other Policies of a similar nature, should be verified by the inspection of the Policies, and the Auditor should ascertain that the last premium has been duly paid.

(4) *Assets abroad.*

Where the documents of title relating to assets abroad are not in this country, a certificate should be obtained from the agent, or other party holding the

same, and the Auditor should state in his Report that he has inspected such certificate.

(5) *Machinery and Plant.*

Although Machinery and Plant may form a considerable item in the assets of a business, the Auditor cannot verify the existence of the asset in the same manner as other assets dealt with in this Chapter. The evidence obtained by him in the course of vouching the expenditure incurred on this asset will serve to verify its existence, subject to due consideration of the questions of Depreciation and Repairs.

Where Plant is revalued, either for Fire Insurance purposes or otherwise, the valuation should be examined by the Auditor, and if it is below the book value he should ascertain the cause of the difference.

In the case of Loose Tools and Plant, it is usual for a valuation to be taken each year, and the item treated in the same manner as stock. Where this is done the Auditor will examine the Valuation Sheets, and ascertain that they are properly certified.

(6) *Patents.*

In order to verify the existence of a Patent, the actual Patent should be examined, and where the Patent has been purchased from another Party the Assignment should be inspected, and it should be seen that it has been duly registered. Where a considerable number of Patents are held, a Schedule should be presented to the Auditor, containing their registered number, date, description, and number of years unexpired. The last renewal certificate should also be examined, as unless this is taken out at the prescribed time, the Patent will lapse. Where Patents are held by a Company a resolution should be passed in respect of all Patents allowed to lapse.

The question of the valuation of Patents for Balance Sheet purposes has been considered in Chapter IV., § 6 (b).

(7) Copyrights. ,

Copyright is created by the Copyright Act, 1911, and means the sole right to produce or reproduce the work or any substantial part thereof in any material form whatsoever, to perform, or in the case of a lecture to deliver, the work or any substantial part thereof in public; if the work is unpublished, to publish the work or any substantial part thereof; and shall include the sole right :-

- (a) to produce, reproduce, perform, or publish any translation of the work,
- (b) in the case of a dramatic work, to convert it into a novel or other non dramatic work;
- (c) in the case of a novel or other non-dramatic work, or of an artistic work, to convert it into a dramatic work, by way of performance in public or otherwise,
- (d) in the case of a literary, dramatic, or musical work, to make any record, perforated roll, cinematograph film, or other contrivance by means of which the work may be mechanically performed or delivered,

and to authorise any such acts as aforesaid.

Subject to the provisions of the Act the Author of the work shall be first owner of the Copyright therein and the term for which Copyright subsists is, with certain exceptions, the life of the Author and a period of 50 years after his death.

If the Copyright is assigned the Assignment must be in writing and should be examined by the Auditor. The question of the valuation of Copyrights has been treated in Chapter XI., § 6 (b).

SYNOPSIS OF CHAPTER VI

The Auditor of a Limited Company.

§ 1 — THE APPOINTMENT AND REMUNERATION OF AUDITORS

- (a) Auditors appointed on behalf of the Company
- (b) Joint Auditors
- (c) Local Auditor
- (d) Auditors appointed on behalf of classes of Shareholders or Debenture holders
 - (1) On behalf of Preference Shareholders
 - (2) On behalf of Founders Shareholders
 - (3) On behalf of Debenture holders

2 — THE STATUS OF THE AUDITOR

- (a) As Agent of the Shareholder
- (b) As an Officer of the Company

3 — THE POWERS OF THE AUDITOR

4 — THE DUTIES OF THE AUDITOR

5 — THE AUDITOR'S LIABILITY

6 — THE PUBLICATION OF THE BALANCE SHEET AND AUDITOR'S REPORT

7 — STATEMENT IN THE FORM OF A BALANCE SHEET REQUIRED TO BE FILED WITH THE ANNUAL SUMMARY

8 — THE AUDITOR'S OATH

CHAPTER VI.

THE AUDITOR OF A LIMITED COMPANY.

§ 1. —The Appointment and Remuneration of Auditors.

(a) Auditors appointed on behalf of the Company.

The Appointment and Remuneration of Auditors is dealt with by § 112 of the Companies (Consolidation) Act, 1908, as follows: —

112. —(1) Every company shall at each annual general meeting appoint an auditor or auditors to hold office until the next annual general meeting.

(2) If an appointment of auditors is not made at an annual general meeting, the Board of Trade may, on the application of any member of the company, appoint an auditor of the company for the current year, and fix the remuneration to be paid to him by the company for his services.

(3) A director or officer of the company shall not be capable of being appointed auditor of the company.

(4) A person, other than a retiring auditor, shall not be capable of being appointed auditor at an annual general meeting unless notice of an intention to nominate that person to the office of auditor has been given by a shareholder to the company not less than fourteen days before the annual general meeting, and the company shall send a copy of any such notice to the retiring auditor, and shall give notice thereof to the shareholders, either by advertisement or in any other mode allowed by the articles not less than seven days before the annual general meeting.

Provided that if, after notice of the intention to nominate an auditor has been so given, an annual general meeting is called for a date fourteen days or less after the notice has been given, the notice, though not given within the time required by this provision, shall be deemed to have been properly given for the purposes thereof, and the notice to be sent or given by the company may, instead of being sent or given within the time required by this provision, be sent or given at the same time as the notice of the annual general meeting.

(5) The first auditors of the company may be appointed by the directors before the statutory meeting, and if so appointed shall hold office until the first annual general meeting, unless previously removed by a resolution of the shareholders in general meeting, in which case the shareholders at that meeting may appoint auditors.

(6) The directors may fill any casual vacancy in the office of auditor, but while any such vacancy continues the surviving or continuing auditor or auditors, if any, may act.

(7) The remuneration of the auditors of a company shall be fixed by the company in general meeting, except that the remuneration of any auditors appointed before the statutory meeting, or to fill any casual vacancy, may be fixed by the directors.

It will be observed, that although the Directors have power to appoint the first Auditors before the Statutory Meeting, such Auditors can be removed by a resolution of the Shareholders in General Meeting, and in this way the ultimate right of appointment rests with the Shareholders in every instance, with the exception of a casual vacancy. This emphasises the fact that the Auditor is responsible to the Shareholders, and acts on their behalf, and not on behalf of the Directors. In actual practice, as the Directors are agents for the Shareholders in conducting the affairs of the Company, the Auditor will naturally come into personal contact with them in the course of his duties, and he will sometimes meet Directors who seem to consider that the Auditor exists merely to seal with his official approval the accounts presented by the Board; but it should be remembered that the Auditor is the representative of the Shareholders, and his statutory duties relate to them.

The clause relating to the appointment of an Auditor, other than a retiring Auditor, was first introduced in the Companies Act, 1907, owing to the method, sometimes adopted by Directors, where there was a difference of opinion between the retiring Auditor and themselves, of nominating another Auditor without

notifying the retiring Auditor of their intention so to do, and carrying the appointment of the new Auditor by means of the proxies at their disposal. Such procedure was in many cases detrimental to the general interests of the Shareholders, and was certainly a very poor reward for the Auditor who had too faithfully discharged his duties to them. The fact that notice must be sent to the retiring Auditor, and to all Shareholders prior to the Shareholders' Meeting, in the event of any Auditor other than the retiring Auditor being nominated, prevents any alteration in the appointment without the knowledge of all the Shareholders; and the retiring Auditor is able to place his views before the Shareholders should he wish to do so. It is true that the Act gives no statutory power to the Auditor to attend a Meeting of Shareholders, but in practice he is rarely, if ever, refused admission.

(b) Joint Auditors.

Two or more Auditors are sometimes appointed, particularly in the case of large concerns, such as Banking or Insurance Companies, or where the Regulations of the Company so require. In such cases each Auditor is jointly responsible; but where the work performed by the Auditors is divided by mutual agreement, it may be desirable for each Auditor to avoid responsibility for work he has not performed by a specific statement in the Report of the extent of the Audit carried out by each.

(c) Local Auditors.

Companies carrying on business abroad, such as those possessing foreign branches or mines, frequently employ a Local Auditor or Auditors who audit the

Accounts locally and certify the same before transmission to the Head Office. Such Auditors may be appointed by the London Board of Directors or by the Local Board, or their appointment may be made by the Shareholders in General Meeting. The latter course is preferable as it renders the Local Auditors 'more independent and' they become directly responsible to the Shareholders.

Where a Local Audit of this nature is performed the Company's Auditor will not examine the Returns rendered in detail, but will confine himself to questions of principle, and to ascertaining that the Accounts are properly incorporated in the Head Office Books. In his Report he should state that he has accepted the Foreign Returns as certified by the Local Auditor.

(d) Auditors appointed on behalf of Classes of Shareholders or Debenture-holders.

Auditors are sometimes appointed on behalf of separate classes of Shareholders, such as Preference or Founders' Shareholders; or on behalf of Debenture-holders. The duties of such Auditors are not prescribed by Statute.

(1) On behalf of Preference Shareholders.

An Auditor appointed on behalf of Preference Shareholders should principally direct his attention to ascertaining that the rights of such Shareholders have not been affected by any treatment of the Accounts of the Company which could be called in question.

Where excessive reserves have been made for depreciation or bad debts, or sums have been placed to General Reserve, which would have the effect of preventing the payment of the Preference dividend

for the current year, or reducing the amount thereof, the Preference Shareholders' Auditor should represent his clients' point of view to the Company, and if necessary report on the position.

Where the Preference dividend has been or will be paid in full, the creation of excessive Reserves will not necessarily be detrimental to the interests of the Preference Shareholders, and will be actually in their favour if they have preference as to capital. It should be understood, however, that in no case should the Preference Shareholders' Auditor endeavour to reduce the Reserves below an adequate standard, even although this might have the effect of giving a temporary advantage to his clients.

(2) On behalf of Founders' Shareholders.

An Auditor appointed on behalf of Founders' or Deferred Shareholders should ascertain that the rights of such Shareholders, with regard to the distribution of profits, are duly regarded.

In most cases Directors have power to put to Reserve before the payment of dividends, and where this is done the Auditor should satisfy himself that the proposed appropriation is in the general interests of the Company, and is not directed particularly against the class of Shareholders that he represents. He will report to his clients according to the facts of the case.

(3) On behalf of Debenture-holders.

An Auditor is sometimes appointed on behalf of the Debenture-holders, in order to protect their interests. He should see that the security afforded to his clients is not endangered, and that the clauses

of the Trust Deed relating to the provision of a Sinking Fund, the Redemption of Debentures, payment of Interest, &c., are duly carried out. He should verify the existence of the Title Deeds conveyed to the Trustees for the Debenture-holders, in the case of a fixed charge, and ascertain whether the Company is in a position to deal with them without the authority of the Trustees. The question of Reserves, Depreciation, &c., is important, as if these are not adequately provided for, before dividends are distributed, the general assets of the Company will be reduced, and thus the ultimate security available for the Debenture holders will be diminished.

§ 2. -The Status of the Auditor.

(a) As Agent of the Shareholders.

The question as to how far the Auditor is the agent of the Shareholders was discussed in *Spackman v. Evans* (3 H.L. 236), when Lord Chelmsford dissented from the view expressed in a previous case, that the Auditors were, within the scope of their duty, at least as much the agents of the Shareholders as the Directors. He added, "It seems to me that it would be an unreasonable conclusion from this mode of appointment of these officers, that they were thereby constituted agents so as to conclude the Shareholders by their knowledge of any unauthorized acts of the Directors."

Lord Cranworth stated in the course of the same case: "The Auditors may be agents of the Shareholders, so far as relates to the Audit of the accounts. For the purposes of the Audit, the Auditors will bind the Shareholders."

(b) As an Officer of the Company.

The question as to whether an Auditor is an officer of the Company is of particular importance, as it is only in his capacity as officer that he can be held liable under § 215 of the Companies (Consolidation) Act, 1908, to contribute to the Company, in the event of winding up, any loss occasioned by misfeasance or breach of trust on his part. In the case of the *London & General Bank* (No. 1, 1895, 2 Ch. 166) it was held that the Auditor of a Banking Company, registered under the Companies Act, 1879, is an officer of the Company. Lindley, L.J., read the section of that Act relating to Auditors, and said: "It seems impossible to deny that for some purposes, and to some extent, an Auditor is an officer of the Company. He is appointed by the Company, he is paid by the Company, and his position is described in the section as that of an officer of the Company. He is not a servant of the Directors. On the contrary, he is appointed by the Company to check the Directors, and for some purposes, and to some extent, it seems to me quite impossible to say that he is not an officer of the Company." The Articles of this particular Company frequently referred to the Auditor as an officer of the Company, and thus further influenced the decision.

In the case of the *Kingslon Cotton Mill Co., Ltd.* (1896, 1 Ch. 6), the Articles of the Company relating to the Audit of the Accounts were, in substance, the same as the Audit clauses of Table "A" to the Companies Act, 1862; but the Articles did not specifically refer to the Auditors as officers of the Company. Notwithstanding this, it was held that there was no specific distinction between this case and that of the *London and General Bank*, and that the Auditor was an officer.

An Auditor who has never been properly appointed is not an officer of the Company. (*Western Counties Steam Bakeries & Milling Co., Ltd.*, 1897, 1 Ch. 617.)

There has been no further decision on the subject, but it would seem that since § 112 of the Companies (Consolidation) Act, quoted above, refers to the "office of Auditor" in terms similar to the Act of 1879, an Auditor would be held to be an officer of the Company, in so far as his duties as Auditor are concerned.

There are numerous sections of the Companies (Consolidation) Act, 1908, under which, if default is made in complying with the requirements thereof, the Company, and every Director, Manager, Secretary, or other officer of the Company, who is knowingly a party to the default, are liable to fines varying in amount according to the offence; and it is interesting to consider whether an Auditor who, in the course of his duties, becomes aware of a default of this nature, might be held liable as being an officer of the Company. The point has not yet come before the Courts, but it is one of some practical importance, as from time to time the Auditor does become aware of such defaults. The question then arises as to his duty under these circumstances, particularly where the default is persisted in. Probably it would be sufficient for him to give the Company notice in writing of his knowledge of the default, pointing out the consequences thereof, and dissociating himself from any responsibility in connection with it. If he has done this, it cannot well be said that he continues to be knowingly a party to the default. In any event, it could hardly be maintained that an Auditor is an officer of the Company for the purpose of making Returns to Somerset House.

§ 3.—The Powers of the Auditor.

The powers of the Auditor are defined by § 113 (1) of the Companies (Consolidation) Act, 1908, as follows :

113.—(1) Every auditor of a company shall have a right of access at all times to the books and accounts and vouchers of the company, and shall be entitled to require from the directors and officers of the company such information and explanation as may be necessary for the performance of the duties of the auditors.

It will be observed that the Auditor has a right of access at all times to the books, accounts, and vouchers of the Company. He can therefore inspect these at any time he chooses. In practice it is usual for the Auditor to arrange a date with the Directors and it is not customary for him to attend without giving due notice. It is important, however, for the Auditor to remember that he has a statutory power to attend without notice, and it may be necessary for him to exercise this power in cases where he suspects fraud or irregularity.

The phrase “books, accounts and vouchers” will include, not only the financial books of the Company, but all the books, whether statutory, statistical, or memoranda. Before this power was afforded, the Auditor was sometimes refused access to the Minute Book of the Company; but this is now no longer possible. In a similar manner the term “vouchers” will include all or any of the correspondence of the Company which may in any way serve to vouch for the accuracy of the accounts.

The power entitling the Auditor to require from the Directors and officers of the Company such information and explanation as may be necessary for the performance of his duties as Auditor, is a most important one. The power is very wide, and it would seem that the decision as to what information and explanation

is necessary is left in the discretion of the Auditor. If information or explanation is refused, on the ground that the Directors consider it is not necessary for the performance of the duties of the Auditor, the Auditor can report to the Shareholders that he has not obtained all the information and explanations he has required.

In a case where negligence was alleged against the Auditors by the Directors of a Company who refused them access to the books for the purposes of the audit, the Court will not make an order on the application of the Auditors for access to the books, it being the practice of the Court, in cases affecting internal management, to direct that a Meeting of Shareholders be summoned to determine their wishes in the matter. The Auditors are the servants of the Company appointed by the Company, and if the Company does not desire them to act, no Court will, by mandatory injunction, force them upon it. (*Cuff v. London and County Land and Building Co.*, 1912, L. J. C. A. 426.)

It will be observed that the Act does not specifically state that a Balance Sheet must be presented to the Auditor, although the Auditor is required to report to the Shareholders on every Balance Sheet laid before them in General Meeting. It is the duty of the Directors to prepare the Balance Sheet for presentation to the Auditor, and consequently the books ought to be presented to the Auditor balanced. It cannot be said to be the duty of the Auditor to balance the books, neither should he undertake to do so, unless specially requested by the Directors, when he will be acting in the capacity of Accountant, and not as Auditor. Any additional work of this nature should be specially remunerated.

Where the Company's accounts are kept on a

system of which the Auditor does not approve, he cannot require the Directors to amend their system, but he can request them to do so, and in the majority of cases the Auditor's advice will be followed. Where, however, the suggestions are not carried out, he should only refer the matter to the Shareholders, if in his opinion the system employed is detrimental to their interests. Should the method of recording the accounts be so inadequate as to result in insufficient evidence being available, the Auditor must state that he has not obtained all the information and explanations he has required, owing to the inadequate method of account-keeping adopted.

§ 4. -The Duties of the Auditor.

The duties of the Auditor are defined by § 113 (2) of the Companies (Consolidation) Act, 1908, as follows: -

113. (2) The auditors shall make a report to the shareholders on the accounts examined by them, and on every balance sheet laid before the company in general meeting during their tenure of office, and the report shall state

- (a) whether or not they have obtained all the information and explanations they have required, and
- (b) whether, in their opinion, the balance sheet referred to in the report is properly drawn up so as to exhibit a true and correct view of the state of the company's affairs according to the best of their information and the explanations given to them, and as shown by the books of the company

No limitation can be placed upon the duties of the Auditor under this section, either by the Articles of the Company or by any resolution of the Shareholders.

A clause in the Articles, giving the Directors of a Company power to form an Internal Reserve Fund, which should not be disclosed on the Balance Sheet, and which should be utilised in whatever way the

Directors thought fit ; and providing that the Auditors should have access to the accounts relating to such Reserve Fund, and that it should be their duty to see that the same was applied to the purposes of the Company as specified in the Special Articles, but that they should not disclose any information with regard to the same to the Shareholders or otherwise was held to be *ultra vires*, as being a limitation of the statutory duties of the Auditors, and inconsistent with § 113. (*Newton v. Birmingham Small Arms Co.*, 1906, 2 Ch. 378.)

Buckley, J., said : " Any regulations which precluded the Auditors from availing themselves of all the information to which under the Act they are entitled, as material for the Report which under the Act they are to make as to the true and correct state of the Company's affairs, are, I think, inconsistent with the Act."

The Auditor is not required to certify as to the correctness of the Balance Sheet ; all he is required to do is to report to the Shareholders whether in his opinion it is correct. The phrase, " according to the best of their information and the explanations given to them," was first inserted in the Companies Act, 1907 ; and although it limits the liability of the Auditor in one sense, it extends it in another. The Auditor will not be held responsible if he has acted on information and explanations which he believes to be *bonâ fide*, but which are as a matter of fact untrue or incorrect, provided he has exercised reasonable skill and diligence in testing the information supplied to him. On the other hand, the Balance Sheet may be correct as shown by the books of the Company, but there may be information at the disposal of the Auditor which would

indicate that the books themselves were incorrect, and he cannot report to the Shareholders in the terms of the Act, unless he takes account of such knowledge.

In the same manner the phrase, "as shown by the books of the Company," limits the liability of the Auditor to some extent. He cannot be held responsible for transactions which are omitted from the books, unless by the exercise of reasonable skill and diligence he could have discovered them. At the same time the duty of the Auditor is not confined to comparing the Balance Sheet with the books to see that it agrees. On this point the remarks of Lindley, L.J., in *re London & General Bank* (No. 2, 1895, 2 Ch. 682), are pertinent :

"The Auditor's business is to ascertain and state the true financial position of the Company at the time of the Audit, and his duty is confined to that. But then comes the question: How is he to ascertain such position? The answer is: By examining the books of the Company. But he does not discharge his duty by doing this without inquiry, and without taking any trouble to see that the books of the Company themselves show the Company's true position. He must take reasonable care to ascertain that they do. Unless he does this, his duty will be worse than a mere formality. The Auditor, however, is not bound to do more than exercise reasonable care and skill in making the inquiries and investigations. He is not an insurer, he does not guarantee that the books do correctly show the true position of the Company's affairs. His obligation is not so onerous as this. He must be honest: that is he must not certify what he does not believe to be true, and he must take reasonable care and skill before he believes that what he certifies is true.

Further duties falling upon the Auditor under the Companies (Consolidation) Act, 1908, are referred to in § 65, under which the Auditor, if appointed before the first Statutory Meeting, must certify the Statutory Report issued to the Shareholders, so far as it relates to certain matters; and in § 26, under which the statement in the form of a Balance Sheet required to be filed with the Annual Summary, must be audited by the Company's Auditors. The Auditor's duties

under § 65 of the Act are considered in Chapter IX, § 7, and those under § 26 of the Act in § 7 of this Chapter.

The duties of the Auditor of a Private Company are the same as those of the Auditor of a Public Company, with the exception that it will not be necessary to Audit the Statement in the form of a Balance Sheet, as this need not be filed with the Annual Summary; or the Statutory Report as this need not be filed.

It is sometimes assumed that because the great bulk of the shares in a Private Company are held by one or two individuals, who may be Directors, such persons have the right to vary the duties of the Auditor, and place restrictions upon what he shall or shall not do. It need hardly be pointed out that any such attempt to limit the rights and duties of the Auditor is *ultra vires*.

§ 5. The Auditor's Report.

Where the Auditor is satisfied that the Balance Sheet is in order, and does not consider it necessary to make any additions to the statutory wording, the form of his Report will be as follows :—

“In accordance with section 113 of the Companies (Consolidation) Act, 1908, I beg to report to the shareholders that I have obtained all the information and explanations I have required. I have examined the above Balance Sheet with the books and vouchers of the Company, and am of the opinion that the same is properly drawn up so as to exhibit a true and correct view of the state of the Company's affairs according to the best of my information and the explanations given to me, and as shown by the books of the Company.”

Where a difference of opinion has arisen between the Auditor and the Directors as to the treatment of certain items in the accounts, or the correctness of the Balance Sheet, and the Directors do not see their way to adjust the accounts as the Auditor may desire, the latter must qualify his Report accordingly.

The following illustration is given of an Auditor's Report made subject to qualifications.

"In accordance with section 113 of the Companies (Consolidation) Act, 1908, I beg to report to the Shareholders that I have received all the information and explanations I have required. I have examined the above Balance Sheet with the books and vouchers, and desire to draw the attention of the Shareholders to the following points:—

- (1) Stock to the value of £5,000 has been pledged to secure advances. In my opinion this fact should have been disclosed on the face of the Balance Sheet.
- (2) A considerable quantity of copper has been taken into stock at market price, which is in excess of cost price to the extent of £15 per ton. In my opinion such stock should have been valued at cost, as no profit had been earned at the date of the Balance Sheet, the stock not then having been sold. The stock sheets have been certified as correct by the Managing Director.
- (3) Included in the Debtors is a Book Debt of £2,000 which has been outstanding two years, but which the Directors consider to be good. The evidence afforded is not sufficient to enable me to take this view, and I am of opinion that the debt is doubtful, and that a reserve should be made against it.
- (4) No provision has been made for depreciation of leasehold premises and plant and machinery, but I understand the Directors propose to submit to the Shareholders a resolution to appropriate £2,000 of the profits for this purpose. In my opinion the depreciation for the year (which I estimate at £2,500) should have been charged to the Profit and Loss Account as an expense before arriving at the profits available for appropriation, when the assets in question would have appeared in the Balance Sheet at their proper value.

Subject to the above remarks, I am of opinion that the above Balance Sheet is properly drawn up so as to exhibit a true and correct view of the state of the Company's affairs according to the best of my information and the explanations given to me, and as shown by the books of the Company."

Strong pressure is sometimes put upon the Auditor to induce him to refrain from making certain comments in his Report, on the ground that the fact of his doing so will be detrimental to the interests of the Shareholders, and he is sometimes asked whether he cannot indicate in more or less general terms the point at issue without specifically stating the facts. The Auditor who allows himself to be persuaded to do this

runs the very serious risk of being held to have failed in discharging his duty to the Shareholders.

Lindley, L.J., said, *In re London & General Bank* (No. 2, 1895, 2 Ch. 682) :

“ A person whose duty it is to convey information to others does not discharge that duty by simply giving them so much information as is calculated to induce them or some of them to ask for more. Information and means of information are by no means equivalent terms. . . . An Auditor who gives Shareholders the means of information instead of information in respect of a Company's financial position, does so at his peril, and runs the very serious risk of being held judicially to have failed to discharge his duty.”

When the Companies Act, 1907, was passed, the provisions of which were subsequently merged in the Companies (Consolidation) Act, 1908, the Council of the Institute of Chartered Accountants in England and Wales obtained the joint opinion of eminent Counsel on the clauses particularly affecting Auditors. That opinion was as follows :

(1) In our opinion the Auditors' Report to be made pursuant to paragraph (2) of section 19 of the Companies Act, 1907, should, in cases where the Auditors have no special comments to make, run as follows :

Report of the Auditors to the Shareholders of
Limited.

We have audited the Balance Sheet of the
Limited, dated the day of and (here identify
it as : “ above set forth ” or “ within contained,” or “ a copy of
which is annexed hereto and initialed by us,” or “ a copy of which
has been initialed by us ”).

We have obtained all the information and explanations we
have required.

In our opinion such Balance Sheet is properly drawn up so
as to exhibit a true and correct view of the state of the Company's
affairs according to the best of our information and the explanations
given us, and as shown by the books of the Company.

We consider that the Report should identify very clearly the particular Balance Sheet to which it refers, so that there may be no room for after-dispute or confusion, and no danger that by mistake or otherwise the Balance Sheet submitted to the Shareholders, though bearing the proper date, should not be the one actually referred to in the Report.

Perhaps the surest mode of identification is to write the Report at the foot, or endorse it on the Balance Sheet to be submitted, for by these means the two documents are made inseparable ; or in other

words, the Report runs with the Balance Sheet. But, as above appears, there are alternatives open. In any case the Auditors should keep a copy of the Balance Sheet they audit, and place a memorandum of identity thereon, so that if the question arises they may be able to testify certainly as to the matter.

(2) Under the section, the Auditors' Report is to be attached to the Balance Sheet, or referred to at the foot thereof. In the former case we consider that the attachment should be effected either by printing the two documents continuously on the same sheet of paper, or by fastening the Report to the Balance Sheet. We consider that the best mode of attachment is that the Report should be written or printed at the foot of the Balance Sheet, or endorsed thereon.

(3) If the Report is not attached to the Balance Sheet, there should at the foot of the Balance Sheet be words referring to the Report, e.g. "The Report to the Shareholders of Messrs. , the Company's Auditors, on the above Balance Sheet, is dated the day of , and is open to inspection."

In our opinion it is for the Directors to make the reference and settle the form thereof, and not for the Auditors.

(4) In our opinion the Act does not impose on the Auditors the duty of seeing that the Report is attached to the Balance Sheet, or referred to at the foot thereof. This duty, we consider, is imposed on the Company and its Directors.

(5) It appears to us that it is not the duty of the Auditors to see that the Balance Sheet is signed by the required number of Directors. Sub-section (3) of section 19 clearly contemplates that the Balance Sheet is to be issued after the Report has been made, for a copy is to be attached or referred to. As to cases in which there are no officers called Directors, the Balance Sheet should be signed by the manager or other person occupying the position of Director, for section 30 of the Act of 1900, with which the Act of 1907 is to be read (*see* section 52), provides that the term "Directors" includes any person occupying the position of Director, by whatever name called.

(6) In our opinion it is not the duty of the Auditors to supply to Shareholders, when requested, copies of the Balance Sheet and their Report, or to furnish information to individual Shareholders.

(7) In our opinion the statement in the form of a Balance Sheet referred to in section 21 of the Act of 1907 is a document to be submitted by the Directors to the Auditors for audit. The document must contain, as the section requires, a summary of the Company's capital, liabilities and assets, giving such particulars as would disclose the general nature of such liabilities and assets, and how the value of the fixed assets has been arrived at, but it is not necessary to include in it a statement of profit or loss. We consider that in many cases the last audited Balance Sheet will be a sufficient statement in the form of a Balance Sheet; but where the Balance Sheet does not state how the value of the fixed assets has been arrived at, it would, in order to comply with the section, have to be supplemented by a note or memorandum stating how the value of such assets was arrived at.

Where the Balance Sheet, whether supplemented as aforesaid or otherwise, is adopted for the purposes of the section as a statement in the form of a Balance Sheet, it should, in our opinion, be accompanied by a copy of the Report of the Auditors on such Balance Sheet; and if it is so supplemented, the Auditors should certify that according to the best of their information the method specified in the supplementary note or memorandum has been adopted.

We consider, however, that it is open to the Directors to frame the statement "in the form of a Balance Sheet" referred to in section 21 in more general terms than the Balance Sheet, provided that it complies with the requirements of the section; but in such case the statement must be audited by the Company's Auditors, and the result of the audit should be certified at the foot of the statement.

(8) As to the general duties of the Auditors, under section 19 of the Act of 1907, we consider that they should perform these duties with due regard to the provisions of the Company's Articles of Association, in so far as those Articles are consistent with the Acts, and that they should call for all such information and explanations as they consider requisite to enable them to make the Report to the Shareholders contemplated by the section. They should not have the least hesitation in reporting fully as to any unsatisfactory features in the position.

Lastly, we do not consider that the Auditor's duties are limited to a comparison of the figures in the Balance Sheet and those in the books. No doubt he has to examine the books, but, as Lord Justice Lindley said *In re The London & General Bank* (1895, 2 Ch. 683), "he does not discharge his duty by doing this without inquiry and without taking any trouble to see that the books themselves show the Company's true position. He must take reasonable care to ascertain that they do so."

R. B. FINLAY.

FELIX CASSEL.

A. R. KIRBY.

FRANCIS B. PALMER.

Temple, 13th March, 1908.

§ 6.—The Publication of the Balance Sheet and Auditor's Report.

Section 113 of the Companies (Consolidation) Act, 1908, further provides as follows:—

113.—(3) The balance sheet shall be signed on behalf of the board by two of the directors of the company, or if there is only one director, by that director, and the auditor's report shall be attached to the balance sheet, or there shall be inserted at the foot of the balance sheet a reference to the report, and the report shall be read before the

company in general meeting, and shall be open to inspection by any shareholder.

Any shareholder shall be entitled to be furnished with a copy of the balance sheet and auditors' report at a charge not exceeding sixpence for every hundred words.

(4) If any copy of a balance sheet which has not been signed as required by this section is issued, circulated, or published, or if any copy of a balance sheet is issued, circulated, or published without either having a copy of the auditors' report attached thereto or containing such reference to that report as is required by this section, the company, and every director, manager, secretary, or other officer of the company who is knowingly a party to the default, shall on conviction be liable to a fine not exceeding fifty pounds.

(5) In the case of a banking company registered after the fifteenth day of August eighteen hundred and seventy nine

(a) if the company has branch banks beyond the limits of Europe, it shall be sufficient if the auditor is allowed access to such copies of and extracts from the books and accounts of any such branch as have been transmitted to the head office of the company in the United Kingdom, and

(b) the balance sheet must be signed by the secretary or manager (if any), and where there are more than three directors of the company by at least three of those directors, and where there are not more than three directors by all the directors.

It is important to observe that the Auditor's Report must either be attached to the Balance Sheet, or a reference thereto inserted at the foot of the Balance Sheet. In the great majority of cases it is usual for this Report to be printed at the foot of the Balance Sheet. The choice, however, as to whether it should appear in this manner, or whether only a reference to the Report should be made, lies with the Directors; and if the Auditor's Report contains references or information which it would be disadvantageous to the interests of the Company to publish, the Report is not as a rule printed.

This alternative method was first instituted by the Companies Act, 1907. Under the old procedure the Auditor sometimes found himself in a difficult situation. In cases where his Report contained information of

importance, which it might have been detrimental to the interests of the Company to publish, he had to consider whether he should insert it in his Report to be printed on the Balance Sheet, or whether he should sign a more or less colourless Report for publication, referring therein to a separate Report, which would contain the information it was not desirable to make public.

The present law is free from these ambiguities. The Auditor has only to make one Report, and it is optional whether this is attached to the Balance Sheet or a reference thereto made on the Balance Sheet. The difficulties attendant on publication therefore no longer exist. The Act does not provide that the reference to the Report (if any) must be signed by the Auditors, and it would appear to be for the Directors, and not the Auditors, to make the reference, and settle the form thereof, which might be as follows:—

“The Report to the Shareholders of Messrs. X. Y. & Co., the Company’s Auditors, on the above Balance Sheet, is dated the day of , and is open to inspection”

The Report must be read before the Shareholders in General Meeting, whether published with the Balance Sheet or not, and any Shareholder is entitled to be furnished with a copy of the Balance Sheet and Auditor’s Report, on payment of the prescribed charge, though the phrase “any Shareholder” must be interpreted in conjunction with the succeeding section, which reads as follows:

114. (1) Holders of preference shares and debentures of a company shall have the same right to receive and inspect the balance sheets of the company and the reports of the auditors and other reports as is possessed by the holders of ordinary shares in the company.

(2) This section shall not apply to a private company, nor to a company registered before the first day of July nineteen hundred and eight.

This clause was included in the Companies Act, 1907, and only applies to Companies registered after the commencement of that Act. Previously it was common to find that Preference Shareholders had no right to inspection of the Balance Sheet and Report, unless their dividend was in arrear. This was manifestly unreasonable, as Preference Shareholders are as much Members of a Company as Ordinary Shareholders. The extension of this right to Debenture-holders is a recognition of the fact that, although they are not members, their interests are liable to be affected in the same manner as those of Shareholders, and consequently they ought to be afforded similar information as regards the position of the Company.

§ 7.—Statement in the form of a Balance Sheet, required to be filed with the Annual Summary.

Section 26 of the Companies (Consolidation) Act, 1908, provides that the Annual Summary in the case of a Public Company must contain a statement in the form of a Balance Sheet, audited by the Company's Auditors. The precise wording of the section is important, and is as follows :—

26.—(3) The summary must also (except where the company is a private company) include a statement, made up to such date as may be specified in the statement in the form of a balance sheet, audited by the company's auditors, and containing a summary of its share capital, its liabilities and its assets, giving such particulars as will disclose the general nature of the liabilities and assets, and how the values of the fixed assets have been arrived at, but the balance sheet need not include a statement of profit and loss.

It should be noted that this statement is not necessarily the same as the Balance Sheet submitted to the

Shareholders at the General Meeting. It must be in the form of a Balance Sheet, but need not include any statement of profit or loss.

The statement must contain a summary of the Company's Share Capital, its Liabilities and its Assets, giving such particulars as will disclose the general nature of those liabilities and assets, and how the values of the fixed assets have been arrived at. The latter requirement is important, and is not always easy to fulfil. Where the fixed assets appear "at cost," those words should be added; and where depreciation has been written off, the phrase "at cost, less depreciation" should be used, although this will not necessarily imply that adequate provision has been made for depreciation; where the assets have been re-valued, the authority for the valuation should be referred to.

It appears that the floating assets may be summarized considerably, items such as "Sundry debtors, stock-in-trade, goods and other assets abroad" being extended in one total; but in the case of fixed assets discrimination must be made between those valued on different principles. In *Galloway v. Schill Seebohm & Co.* (1912, L. J. K. B. 752), goodwill, trade marks, machinery, furniture and fixtures were lumped in one sum with a note that the goodwill and trade marks were included at the sum at which they were taken over by the Company, the remaining items being at cost, less depreciation. The Court held that the value of the goodwill and trade marks must be separated from the value of the machinery, furniture and fixtures, and that it was not in compliance with the requirements of the section to include in one item assets, part of which were valued on one principle and the remainder on a different

principle, or to include in one item tangible and intangible assets. Where different considerations apply to the different classes of assets, it is necessary to have separate figures given. For the purpose of this section goodwill is a fixed asset

The statement must be made up to a date specified therein, but no particular date is required. In most cases, no doubt, the date will be the same date as that of the Company's Balance Sheet, but this is not obligatory, and, where it is thought desirable to adopt another date, this can be done.

The Statement must be audited by the Company's Auditors, but the Act does not require that the Auditors should place any Certificate upon the Statement, or specify what particulars such Certificate should contain. It is the practice of Somerset House, however, to require the Statement to contain a copy of a Certificate by the Auditors. In most cases the Balance Sheet presented to the Shareholders is so framed that it can be utilised to comply with the requirements of this section. The printed Balance Sheet, with a printed copy of the Auditor's Report attached, can then be inserted on the Annual Summary, and this will be accepted. As already indicated, however, the Company's Balance Sheet may convey more information than it is desired to make public in this manner, or the Auditor's Report may refer to certain matters which it is not desired to disclose. Under such circumstances the Statement must afford the required particulars, and the Auditor's Certificate might be worded as follows: -

"I have audited the above Statement in the form of a Balance Sheet, and in accordance with § 113 of the Companies (Consolidation) Act, 1908, I have made a Report to the Shareholders thereon."

§ 8.—The Auditor's Lien.

An Accountant has probably a lien on Account Books for charges incurred in the writing up of such books (*Burleigh v. Ingram & Clarke, Ltd.*, 1901, 27, Acct. L.R. 65); but it is doubtful whether an Auditor has such a right in respect of books which he has audited even though he properly obtains absolute possession of such books, and improves the records therein during the course of his audit.

In *re Arthur Francis, Ltd* (44, Acct. L.R. 61), a lien was claimed on books and documents in the possession of Accountants on the ground that they had worked upon them and had not been paid either their audit fees or accountancy charges. Swinfen Eady, J., made an order that the books should be produced to the Liquidators of the Company without prejudice to the lien, if any, of the respondents.

SYNOPSIS OF CHAPTER VII.

The Companies Acts, 1908 to 1917.

- § 1—THE VARIOUS CLASSES OF COMPANIES
 - (a) Limited and Unlimited Companies (§§ 2, 115)
 - (b) Public and Private Companies (§ 121)
- 2—THE MEMORANDUM (§§ 3, 4, 7)
- 3—THE ARTICLES OF ASSOCIATION (§§ 10, 11, 13)
- 4—THE REGISTER OF MEMBERS (§§ 25, 27, 30, 32, 37)
- 5—THE ANNUAL LIST OF MEMBERS AND SUMMARY (§ 26)
- 6—ISSUE OF SHARE WARRANTS (§ 37)
- 7—DIFFERENTIATION IN ISSUE OF SHARES (§ 39)
- 8—REDUCTION OF PAID UP CAPITAL BY RETURN OF PROFITS (§ 40)
- 9—ALTERATION OF SHARE CAPITAL (§ 41)
- 10—REORGANISATION OF SHARE CAPITAL (§ 45)
- 11—REDUCTION OF SHARE CAPITAL (§§ 46, 53)
- 12—CREATION OF RESERVE LIABILITY (§ 59)
- 13—UNLIMITED LIABILITY OF DIRECTOR (§§ 60, 61)
- 14—FIRST STATUTORY MEETING (§ 65)
- 15—ANNUAL GENERAL MEETING (§ 64)
- 16—EXTRAORDINARY GENERAL MEETING (§ 66)
- 17—EXTRAORDINARY AND SPECIAL RESOLUTION (§§ 69, 70)
- 18—MINUTE BOOKS (§ 71)
- 19—APPOINTMENT AND QUALIFICATION OF DIRECTOR (§§ 72, 74)
- 20—REGISTER OF DIRECTORS (§ 75)
- 21—THE PROMOTERS (§§ 80, 81)
- 22—STATEMENT IN LIEU OF PROSPECTUS (§ 82)
- 23—LIABILITY FOR STATEMENT IN PROSPECTUS (§ 84)
- 24—ALLOTMENT OF SHARES (§§ 85, 86)
- 25—RESTRICTIONS ON COMMENCEMENT OF BUSINESS (§ 87)
- 26—RETURN OF ALLOTMENTS (§ 88)
- 27—COMMISSIONS AND DISCOUNT (§§ 89, 90)
- 28—PAYMENT OF INTEREST ON CAPITAL (§ 91)
- 29—ISSUE OF SHARE AND DEBENTURE CERTIFICATES, &c (§ 92)
- 30—REGISTRATION OF MORTGAGES AND CHARGES (§§ 93, 96, 99)
- 31—THE REGISTER OF MORTGAGES (§ 100)
- 32—REGISTER OF DEBENTURE HOLDERS (§ 102)
- 33—IRREDEMPABLE DEBENTURES (§ 103)
- 34—REISSUE OF REDEEMED DEBENTURES (§ 104)
- 35—STATEMENT TO BE PUBLISHED BY BANKING AND CERTAIN OTHER COMPANIES (§ 108)
- 36.—INVESTIGATION BY BOARD OF TRADE INSPECTORS (§ 109)
- 37.—INVESTIGATION BY INSPECTORS APPOINTED BY THE COMPANY (§§ 110, 111)
- 38.—AUDITORS (§§ 112, 113, 114)
- 39.—LIABILITY OF DIRECTORS AND OFFICERS FOR MISFEASANCE OR BREACH OF TRUST (§§ 215, 279)
- 40.—PENALTIES FOR FALSE STATEMENTS. (§ 281)
- 41.—THE COMPANIES (PARTICULARS AS TO DIRECTORS) ACT 1917.
- 42.—THE COMPANIES (FOREIGN INTERESTS) ACT, 1917

CHAPTER VII.

THE COMPANIES ACTS, 1908 to 1917.

The Companies (Consolidation) Act, 1908, repealed and re-enacted the Companies Acts, 1862-1907, and this Act, together with the Companies Act, 1913, and those mentioned below, are known collectively as the Companies Acts, 1908 to 1917. It is proposed here to deal with those sections with which Auditors are particularly concerned. In the closing paragraphs of the Chapter the Companies (Particulars as to Directors) Act, 1917, and the Companies (Foreign Interests) Act, 1917, are referred to.

§ 1. --The various Classes of Companies.

(a) Limited and Unlimited Companies.

Companies may either be (1) limited by shares, (2) limited by guarantee, or (3) unlimited.

✓ § 2 defines these classes as follows :--

2. Any seven or more persons (or, where the company to be formed will be a private company within the meaning of this Act, any two or more persons) associated for any lawful purpose may, by subscribing their names to a memorandum of association and otherwise complying with the requirements of this Act in respect of registration, form an incorporated company, with or without limited liability (that is to say), either--

- (i) A company having the liability of its members limited by the memorandum to the amount, if any, unpaid on the shares respectively held by them (in this Act termed a company limited by shares); or
- (ii) A company having the liability of its members limited by the memorandum to such amount as the members may respectively thereby undertake to contribute to the assets of the company in the event of its being wound up (in this Act termed a company limited by guarantee); or
- iii) A company not having any limit on the liability of its members (in this Act termed an unlimited company).

Under § 1 no Company, Association, or Partnership consisting of more than ten persons shall be formed for the purpose of carrying on the business of banking, or consisting of more than 20 persons for the purpose of carrying on any other business, that has for its object the acquisition of gain, unless it is registered as a Company under this Act, or is formed in pursuance of some other Act of Parliament, or Letters Patent, or is a Company working mines within the Stannaries.

In the event of the number of the members of a Company being reduced below seven persons, or in the case of a Private Company below two, § 115 provides as follows: --

115. If at any time the number of members of a company is reduced, in the case of a private company, below two, or, in the case of any other company, below seven, and it carries on business for more than six months while the number is so reduced, every person who is a member of the company during the time that it so carries on business after those six months, and is cognisant of the fact that it is carrying on business with fewer than two members, or seven members, as the case may be, shall be severally liable for the payment of the whole debts of the company contracted during that time, and may be sued for the same, without joinder in the action of any other member.

(b) Public and Private Companies.

Companies may be further divided into Public and Private Companies. The Act does not specifically define a Public Company, but it defines a Private Company, and all Companies limited by shares which are not Private Companies may be termed Public Companies.

A Private Company is defined by § 121 as follows: --

121.—(1) For the purposes of this Act the expression “private company” means a company which by its articles —

- (a) restricts the right to transfer its shares; and
- (b) limits the number of its members (exclusive of persons who are in the employment of the company) to fifty; and
- (c) prohibits any invitation to the public to subscribe for any shares or debentures of the company.

(2) A private company may, subject to anything contained in the memorandum or articles, by passing a special resolution and by filing with the registrar of companies such a statement in lieu of prospectus as the company, if a public company, would have had to file before allotting any of its shares or debentures, together with such a statutory declaration as the company, if a public company, would have had to file before commencing business, turn itself into a public company

(3) Where two or more persons hold one or more shares in a company jointly they shall, for the purpose of this section, be treated as a single member

Under the Companies Act, 1913, the law relating to Private Companies is amended. This amendment was necessary in consequence of the fact that before it was passed, a Company could constitute itself a Private Company by merely inserting certain provisions in its Articles in accordance with § 121 of the Companies (Consolidation) Act, 1908, without being under any obligation to pay regard to those provisions. The effect of the Act is to make such provisions in the Articles operative, but in order to do this it was necessary to provide that the maximum number of members should be reckoned exclusive of persons who are, or have been in the employment of the Company and continue to be members.

The following is the principal clause of the Act :—

1.—(1) Where the articles of a company include the provisions which, by section 121 of the Companies (Consolidation) Act, 1908, as amended by this Act, are required to be included therein in order to constitute the company a private company for the purposes of that Act, and default is made in complying with any of those provisions, the company shall cease to be entitled to the privileges and exemptions conferred on private companies under the provisions of that Act mentioned in the Schedule to this Act, and thereupon the said provisions shall apply to the company as if it were not a private company:

Provided that the court, on being satisfied that the failure to comply with the conditions was accidental or due to inadvertence or to some other sufficient cause, or that on other grounds it is just and equitable to grant relief, may, on the application of the company or any other person interested and on such terms and conditions as seem to the court just and expedient, order that the company be relieved from such consequences as aforesaid.

(2) In sub-section (1) of the said section 121 of the Companies (Consolidation) Act, 1908, for paragraph (b) the following paragraph shall be substituted.—

“(b) Limits the number of its members (exclusive of persons who are in the employment of the company and of persons who having been formerly in the employment of the company, were while in such employment and have continued after the determination of such employment to be members of the company) to fifty, and ”.

(3) Every private company shall send with the annual list of members and summary required to be sent under section 26 of the Companies (Consolidation) Act, 1908, a certificate signed by a director or the secretary that the company has not, since the date of the last return, or in the case of a first return since the date of the incorporation of the company, issued any invitation to the public to subscribe for any shares or debentures of the company, and where the list of members discloses the fact that the number of members of the company exceeds fifty, also a certificate so signed that such excess consists wholly of persons who under section 121 of that Act, as amended by this section, are to be excluded in reckoning the number of fifty

A Private Company is exempt from the following obligations imposed on Public Companies :

- (1) Minimum number of members may be two instead of seven. (§ 2.)
- (2) It need not file a statement in lieu of a prospectus with the Registrar of Joint Stock Companies. (§ 82.)
- (3) The restrictions on the commencement of business do not apply. (§ 87.)
- (4) The restrictions on the appointment of Directors do not apply. (§ 72.)
- (5) The restrictions on the allotment of shares do not apply. (§ 85.)
- (6) It need not file or forward to its members the Statutory Report. (§ 65.)
- (7) It need not include in its Annual Summary a statement in the form of a Balance Sheet. (§ 26.)
- (8) It need not give to its Preference Shareholders and Debenture-holders the right to receive and inspect the Balance Sheets of the Company, and the Reports of the Auditors, &c. (§ 114.)

§ 2.—The Memorandum.

The contents of the Memorandum in the case of a Company limited by shares are defined by § 3 as follows :—

3. In the case of a company limited by shares—

(1) The memorandum must state --

(i) The name of the company, with " Limited " as the last word in its name ;

(ii) The part of the United Kingdom, whether England, Scotland, or Ireland, in which the registered office of the company is to be situate ;

(iii) The objects of the company ;

(iv) That the liability of the members is limited ;

(v) The amount of share capital with which the company proposes to be registered, and the division thereof into shares of a fixed amount.

In the case of a Company limited by Guarantee, § 4 requires that the Memorandum must state in addition to the particulars already dealt with above :—

4.—(1)—(v) That each member undertakes to contribute to the assets of the company in the event of its being wound up while he is a member, or within one year afterwards, for payment of the debts and liabilities of the company contracted before he ceases to be a member, and of the costs, charges, and expenses of winding up, and for adjustment of the rights of the contributories among themselves, such amount as may be required, not exceeding a specified amount.

The Auditor should peruse the Memorandum, and particularly the Objects clause, since occasionally the point may arise as to whether certain transactions are *intra vires* the Company. If transactions have been entered into which are not within the scope of the Objects clause, the Auditor should draw the attention of the Shareholders to the facts in his Report. Owing to the comprehensive nature of most Objects clauses, however, this contingency rarely arises.

The Memorandum must state the amount of Share Capital with which the Company proposes to be

registered, and the division thereof into shares of a fixed amount, but need not afford any further definition of the classes (if any) into which the shares are or may be divided. These powers can be taken in the Articles. A Company can at any time take powers in its Articles to issue shares with preferred or deferred rights, unless the Memorandum of Association expressly prohibits it from doing so. (*Andrews v. The Gas Meter Co.*, 1897 1, Ch. 361; *Ashbury v. Watson*, 1885, 30 Ch. D. 376.)

Where the rights of different classes of Shareholders have been unconditionally defined by the Memorandum they cannot be altered (*Ashbury v. Watson*, 1885, 30 Ch. D. 376), unless the sanction of the Court is obtained for a reorganisation of the Capital under §§ 45 or 120 of the Act, or unless the Memorandum itself provides for such variation. (*Underwood v. London Music Hall*, 1901, 2 Ch. 309.)

§ 7 provides for the alteration of the Memorandum as follows: -

7. A company may not alter the conditions contained in its memorandum except in the cases and in the mode and to the extent for which express provision is made in this Act.

A Company may alter its Memorandum in the following respects: -

- (1) By changing its name. (§ 8.)
- (2) By alteration of its objects. (§ 9.)
- (3) By alteration of its Share Capital. (§§ 41 & 56.)
- (4) By reorganisation of its Share Capital. (§ 45.)
- (5) By reduction of its Share Capital. (§§ 46 & 56.)
- (6) By making the liability of the Directors unlimited. (§ 61.)

§ 3.—The Articles of Association.

The Articles of Association contain the rules and regulations of the Company, and are dealt with in the following sections of the Act:—

10 (1) There may, in the case of a company limited by shares, and there shall in the case of a company limited by guarantee or unlimited, be registered with the memorandum articles of association signed by the subscribers to the memorandum and prescribing regulations for the company.

(2) Articles of association may adopt all or any of the regulations contained in Table A in the First Schedule to this Act.

(3) In the case of an unlimited company or a company limited by guarantee the articles, if the company has a share capital, must state the amount of share capital with which the company proposes to be registered.

(4) In the case of an unlimited company or a company limited by guarantee, if the company has not a share capital, the articles must state the number of members with which the company proposes to be registered, for the purpose of enabling the registrar to determine the fees payable on registration.

11. In the case of a company limited by shares and registered after the commencement of this Act, if articles are not registered, or, if articles are registered, in so far as the articles do not exclude or modify the regulations in Table A in the First Schedule to this Act, those regulations shall, so far as applicable, be the regulations of the company in the same manner and to the same extent as if they were contained in duly registered articles.

The majority of Companies possess special Articles of their own, and the principal clauses are usually as follows:—

- (1) A declaration as to how far the provisions of Table "A" apply, or whether they are expressly excluded.
- (2) A recital of the basis on which the Company is constituted.
- (3) The regulations as to the issue of capital, minimum subscription, payment of underwriting commission, &c.

- (4) Making calls.
- (5) Holding, transferring and transmission of shares.
- (6) Loans on, and forfeiture and surrender of, shares.
- (7) Procedure at general meetings.
- (8) Votes of Members.
- (9) Directors their number, remuneration, qualification, rotation, disqualification and removal.
- (10) Appointment and powers of Managing Directors.
- (11) Proceedings and powers of the Board.
- (12) Accounts and audit.
- (13) Dividends and reserves.
- (14) Notices to Members.
- (15) Rights of Shareholders *inter se*.

It is important to note that, under § 11, if Articles are not registered Table "A," the model set of Articles in the First Schedule to this Act applies, and the Table also applies in so far as the separate Articles have not excluded or modified the regulations of Table "A." The provisions of Table "A" are dealt with in the succeeding Chapter.

A Company can alter its Articles of Association under the following provisions : -

13.—(1) Subject to the provisions of this Act and to the conditions contained in its memorandum, a company may by special resolution alter or add to its articles; and any alteration or addition so made shall be as valid as if originally contained in the articles, and be subject in like manner to alteration by special resolution.

The Company cannot deprive itself of this power to alter its Articles of Association either by statement in the Articles or by contract. Unless the rights of the various classes of Shareholders are defined in the Memorandum, they can be altered by Special Resolu-

tion, although any such alteration must be *bonâ fide* exercised for the benefit of the Company as a whole, and be subject to the general considerations of equity, if it affects the rights of a minority of Shareholders.

Any Special Resolution adding to or altering the Articles must be printed, and a copy filed with the Registrar of Joint Stock Companies. Each copy of the Articles issued subsequently must have a printed copy of the Special Resolution attached to it.

§ 4. —The Register of Members.

25. —(1) Every company shall keep in one or more books a register of its members, and enter therein the following particulars : —

- (i) The names and addresses, and the occupations, if any, of the members, and in the case of a company having a share capital a statement of the shares held by each member, distinguishing each share by its number, and of the amount paid or agreed to be considered as paid on the shares of each member ;
- (ii) The date at which each person was entered in the register as a member ;
- (iii) The date at which any person ceased to be a member.

(2) If a company fails to comply with this section it shall be liable to a fine not exceeding five pounds for every day during which the default continues, and every director and manager of the company who knowingly and wilfully authorises or permits the default shall be liable to the like penalty.

Under § 43, where a Company has converted any of its shares into stock, the Register shall show the amount of stock held by each member instead of the amount of shares.

If Share Warrants have been issued to Shareholders, the particulars must be entered on the Register under the following section :—

37.—(b) On the issue of a share warrant the company shall strike out of its register of members the name of the member then entered therein as holding the shares or stock specified in the warrant as if

he had ceased to be a member, and shall enter in the register the following particulars, namely :

- (i) The fact of the issue of the warrant ;
- (ii) A statement of the shares or stock included in the warrant, distinguishing each share by its number ; and
- (iii) The date of the issue of the warrant

(6) Until the warrant is surrendered, the above particulars shall be deemed to be the particulars required by this Act to be entered in the register of members ; and, on the surrender, the date of the surrender must be entered as if it were the date at which a person ceased to be a member.

No notice of any trust may be entered on the Register.

27. No notice of any trust, expressed, implied or constructive, shall be entered on the register, or be receivable by the registrar, in the case of companies registered in England or Ireland.

This section does not apply to Scotland, where it is the practice to enter notice of trusts. Under the Public Trustee Act, 1906, § 11 (5), the entry of the Public Trustee under that name in the books of a Company shall not constitute notice of a trust.

Under §§ 34 and 35 provisions are made for the keeping of a Colonial Register.

The following section provides for the inspection of the Register : -

30. —(1) The register of members, commencing from the date of the registration of the company, shall be kept at the registered office of the company, and, except when closed under the provisions of this Act, shall during business hours (subject to such reasonable restrictions as the company in general meeting may impose, so that not less than two hours in each day be allowed for inspection) be open to the inspection of any member gratis, and to the inspection of any other person on payment of one shilling, or such less sum as the company may prescribe, for each inspection.

(2) Any member or other person may require a copy of the register, or of any part thereof, or of the list and summary required by this Act, or any part thereof, on payment of sixpence, or such less sum as the company may prescribe, for every hundred words or fractional part thereof required to be copied.

(3) If any inspection or copy required under this section is refused, the company shall be liable for each refusal to a fine not exceeding

two pounds, and to a further fine not exceeding two pounds for every day during which the refusal continues, and every director and manager of the company who knowingly authorises or permits the refusal shall be liable to the like penalty, and, as respects companies registered in England or Ireland, any judge of the High Court, or the judge of the court exercising the statutory jurisdiction in the case of companies subject to that jurisdiction, may by order compel an immediate inspection of the register.

The Court has power to rectify the Register under certain circumstances as follows.

32.—(1) If—

(a) the name of any person is, without sufficient cause, entered in or omitted from the register of members of a company, or

(b) default is made or unnecessary delay takes place in entering on the register the fact of any person having ceased to be a member

the person aggrieved or any member of the company, or the company, may apply to the court for rectification of the register.

§ 5 The Annual List of Members and Summary.

26. (1) Every company having a share capital shall once at least in every year make a list of all persons who, on the fourteenth day after the first or only ordinary general meeting in the year, are members of the company, and of all persons who have ceased to be members since the date of the last return or (in the case of the first return) of the incorporation of the company.

(2) The list must state the names, addresses and occupations of all the past and present members therein mentioned, and the number of shares held by each of the existing members at the date of the return, specifying shares transferred since the date of the last return or (in the case of the first return) of the incorporation of the company by persons who are still members and have ceased to be members respectively and the dates of registration of the transfers, and must contain a summary distinguishing between shares issued for cash and shares issued as fully or partly paid up otherwise than in cash and specifying the following particulars—

- (a) The amount of the share capital of the company, and the number of the shares into which it is divided,
- (b) The number of shares taken from the commencement of the company up to the date of the return,
- (c) The amount called up on each share,
- (d) The total amount of calls received
- (e) The total amount of calls unpaid,

- (f) The total amount of the sums (if any) paid by way of commission in respect of any shares or debentures, or allowed by way of discount in respect of any debentures, since the date of the last return ;
- (g) The total number of shares forfeited ;
- (h) The total amount of shares or stock for which share warrants are outstanding at the date of the return ;
- (i) The total amount of share warrants issued and surrendered respectively since the date of the last return ;
- (k) The number of shares or amount of stock comprised in each share warrant ;
- (l) The names and addresses of the persons who at the date of the return are the directors of the company, or occupy the position of directors, by whatever name called ; and
- (m) The total amount of debt due from the company in respect of all mortgages and charges which are required (or, in the case of a company registered in Scotland, which, if the company had been registered in England, would be required) to be registered with the registrar of companies under this Act, or which would have been required so to be registered if created after the first day of July nineteen hundred and eight.

(3) The summary must also (except where the company is a private company) include a statement, made up to such date as may be specified in the statement, in the form of a balance sheet, audited by the company's auditors, and containing a summary of its share capital, its liabilities, and its assets, giving such particulars as will disclose the general nature of those liabilities and assets, and how the values of the fixed assets have been arrived at, but the balance sheet need not include a statement of profit and loss.

(4) The above list and summary must be contained in a separate part of the register of members, and must be completed within seven days after the fourteenth day aforesaid, and the company must forthwith forward to the registrar of companies a copy signed by the manager or by the secretary of the company.

(5) If a company makes default in complying with the requirements of this section it shall be liable to a fine not exceeding five pounds for every day during which the default continues, and every director and manager of the company who knowingly and wilfully authorises or permits the default shall be liable to the like penalty.

The statement in the form of a Balance Sheet required to be filed in the case of Companies, except Private Companies, under sub-section (3) must be audited by the Company's Auditors, and their duties in this connection have been discussed in Chapter VI.

The following is the official form of the Annual List of Members and Summary as set out in Form E. in the Third Schedule of the Act:—

SUMMARY OF SHARE CAPITAL AND SHARES OF the COMPANY,
LIMITED, made up to the day of 19
(being the fourteenth day after the date of the first ordinary general meeting in 19)

Nominal share capital £	divided into ¹	{	shares of £ each.
		}	shares of £ each.
Total number of shares taken up ¹ to the	day of 19	{	
(which number must agree with the total	shown in the list as held by existing	}	
members).			
Number of shares issued subject to payment wholly in cash			
Number of shares issued as fully paid up otherwise than			
in cash			
Number of shares issued as partly paid up to the extent			
of per share otherwise than in cash			
There has been called up on each of			shares, £
There has been called up on each of			shares, £
There has been called up on each of			shares, £
Total amount of calls received, including payments on			
application and allotment			£
Total amount (if any) agreed to be considered as paid on			
shares which have been issued as fully paid			
up otherwise than in cash			£
Total amount (if any) agreed to be considered as paid on			
shares which have been issued as partly paid			
up to the extent of per share			£
Total amount of calls unpaid			£
Total amount (if any) of sums paid by way of commission			
in respect of shares or debentures or allowed by way of			
discount since date of last summary			£
Total amount (if any) paid on ¹			shares forfeited £

¹ When there are shares of different kinds or amounts (e.g., Preference and Ordinary, or £10 or £5) state the numbers and nominal values separately.

² Where various amounts have been called or there are shares of different kinds state them separately.

³ Include what has been received on forfeited as well as on existing shares.

⁴ State the aggregate number of shares forfeited (if any).

Total amount of debt due from the company in respect of all mortgages and charges which are required (or, in the case of a company registered in Scotland, which, if the company had been registered in England, would be required) to be registered with the registrar of companies, or which would require registration if created after the first day of July, nineteen hundred and eight

Presented for filing by

[illegible]

* The date of registration of each transfer should be given as well as the number of shares transferred on each date. The particulars should be placed opposite the name of the transferor and not opposite that of the transferee, but the name of the transferee may be inserted in the "Remarks" column immediately opposite the particulars of each transfer.

NAMES AND ADDRESSES of the persons who are the Directors of the
Limited, on the day of 19 .

Names

Addresses

NOTE — Banking companies must add a list of all their places of business.

(Signature)

(State whether in public or secret)

Information relating to Directors must be furnished in accordance with § 4 of the Companies (Particulars as to Directors) Act, 1917.

§ 6. -Issue of Share Warrants.

37. (1) A company limited by shares, if so authorised by its articles, may, with respect to any fully paid up shares, or to stock, issue under its common seal a warrant stating that the bearer of the warrant is entitled to the shares or stock therein specified, and may provide, by coupons or otherwise, for the payment of the future dividends on the shares or stock included in the warrant in this Act termed a share warrant

(2) A share warrant shall entitle the bearer thereof to the shares or stock therein specified, and the shares or stock may be transferred by delivery of the warrant

(3) The bearer of a share warrant shall, subject to the articles of the company, be entitled, on surrendering it for cancellation, to have his name entered as a member in the register of members, and the company shall be responsible for any loss incurred by any person by reason of the company entering in its register the name of a bearer of a share warrant in respect of the shares or stock therein specified without the warrant being surrendered and cancelled

(4) The bearer of a share warrant may, if the articles of the company so provide, be deemed to be a member of the company within the meaning of this Act, either to the full extent or for any purposes defined in the articles; except that he shall not be qualified in respect of the shares or stock specified in the warrant for being a director or manager of the company, in cases where such a qualification is required by the articles.

Share Warrants can only be issued if the Articles of the Company give power to do so, or unless power

is taken by Special Resolution, and Warrants to Bearer can only be issued in respect of fully-paid shares or stock. A Private Company cannot take power to issue Warrants, as since they are transmissible to Bearer there is no restriction on delivery.

§ 7.—Differentiation in respect of Calls.

39. A company, if so authorised by its articles, may do any one or more of the following things, namely, —

- (1) Make arrangements on the issue of shares for a difference between the shareholders in the amounts and times of payment of calls on their shares
- (2) Accept from any member who assents thereto the whole or a part of the amount remaining unpaid on any shares held by him, although no part of that amount has been called up :
- (3) Pay dividend in proportion to the amount paid up on each share where a larger amount is paid up on some shares than on others

Such power must be exercised by the Directors *bonâ fide*, and in the general interests of the Company, and not for the advantage of themselves or their friends. (*Alexander v. Automatic Telephone Co.*, 1900, 2 Ch. 56.)

§ 8.—Reduction of Paid-up Capital by Return of Profits.

40.—(1) When a company has accumulated a sum of undivided profits, which with the sanction of the shareholders may be distributed among the shareholders in the form of a dividend or bonus, it may, by special resolution, return the same, or any part thereof, to the shareholders in reduction of the paid-up capital of the company, the unpaid capital being thereby increased by a similar amount.

(2) The resolution shall not take effect until a memorandum, showing the particulars required by this Act in the case of a reduction of share capital, has been produced to and registered by the registrar of companies, but the other provisions of this Act with respect to reduction of share capital shall not apply to a reduction of paid-up share capital under this section.

(3) On a reduction of paid-up capital in pursuance of this section any shareholder, or any one or more of several joint shareholders, may within one month after the passing of the resolution for the

reduction, require the company to retain, and the company shall retain accordingly, the whole of the money actually paid on the shares held by him either alone or jointly with any other person, which, in consequence of the reduction, would otherwise be returned to him or them, and thereupon those shares shall, as regards the payment of dividend, be deemed to be paid up to the same extent only as the shares on which payment has been accepted by the shareholders in reduction of paid-up capital, and the company shall invest and keep invested the money so retained in such securities authorised for investment by trustees as the company may determine, and on the money so invested or on so much thereof as from time to time exceeds the amount of calls subsequently made on the shares in respect of which it has been retained, the company shall pay the interest received from time to time on the securities

(4) The amount retained and invested shall be held to represent the future calls which may be made to replace the share capital so reduced on those shares, whether the amount obtained on sale of the whole or such proportion thereof as represents the amount of any call when made produces more or less than the amount of the call

(5) On a reduction of paid up share capital in pursuance of this section, the powers vested in the directors of making calls on shareholders in respect of the amount unpaid on their shares shall extend to the amount of the unpaid share capital as augmented by the reduction.

(6) After any reduction of share capital under this section the company shall specify in the annual list of members required by this Act the amounts retained at the request of any of the shareholders in pursuance of this section, and shall specify in the statements of account laid before any general meeting of the company the amount of undivided profits returned in reduction of paid up share capital under this section

The precise meaning of this section has been much discussed, and it has been contended that a Company might go on returning profits in reduction of paid-up capital indefinitely without disturbing the balance to the credit of Profit and Loss; and this is so, looking at the matter from the point of view of Double Entry. From the financial point of view, however, such a course is impossible, and the proper method of dealing with the procedure in practice is to set aside to a Capital Reserve the proportion of profits so dealt with.

The Special Resolution must be passed before the profits are divided, otherwise the distribution cannot rank as a reduction of Capital under this section

(*Whitwham v. Piercy*, 1907, 1 Ch. 289), but will rank as an Ordinary Dividend.

§ 9. Alteration of Share Capital.

41.- (1) A company limited by shares, if so authorised by its articles, may alter the conditions of its memorandum as follows (that is to say), it may -

- (a) increase its share capital by the issue of new shares of such amount as it thinks expedient
- (b) consolidate and divide all or any of its share capital into shares of larger amount than its existing shares,
- (c) convert all or any of its paid up shares into stock, and reconvert that stock into paid up shares of any denomination,
- (d) subdivide its shares, or any of them, into shares of smaller amount than is fixed by the memorandum, so, however, that in the subdivision the proportion between the amount paid and the amount, if any, unpaid on each reduced share shall be the same as it was in the case of the share from which the reduced share is derived,
- (e) cancel shares which at the date of the passing of the resolution in that behalf, have not been taken or agreed to be taken by any person, and diminish the amount of its share capital by the amount of the shares so cancelled

(2) The powers conferred by this section with respect to sub-division of shares must be exercised by special resolution.

(3) Where any alteration has been made under this section in the memorandum of a company, every copy of the memorandum issued after the date of the alteration shall be in accordance with the alteration.

If a company makes default in complying with this provision it shall be liable to a fine not exceeding one pound for each copy in respect of which default is made, and every director and manager of the company who knowingly and wilfully authorises or permits the default shall be liable to the like penalty

(4) A cancellation of shares in pursuance of this section shall not be deemed to be a reduction of share capital within the meaning of this Act.

Where a Company has power by its Articles to alter its Share Capital without a Special Resolution, it can do so by an Ordinary Resolution, with the exception of the operation of sub-dividing shares, which must be exercised by Special Resolution.* If the

Company is not authorised by its Articles to perform any of the above operations, it must first acquire the power by Special Resolution, and then the alteration can be made in accordance therewith; but the operation can be effected by means of a single Special Resolution. (*Campbell's case*, 1874, 9 Ch. 1.)

Notice of any alteration must be given to the Registrar of Companies.

§ 10.—Reorganization of Share Capital.

45.—(1) A company limited by shares may, by special resolution confirmed by an order of the court, modify the conditions contained in its memorandum so as to reorganize its share capital, whether by the consolidation of shares of different classes or by the division of its shares into shares of different classes

Provided that no preference or special privilege attached to or belonging to any class of shares shall be interfered with except by a resolution passed by a majority in number of shareholders of that class holding three fourths of the share capital of that class and confirmed at a meeting of shareholders of that class in the same manner as a special resolution of the company is required to be confirmed, and every resolution so passed shall bind all shareholders of the class

(2) Where an order is made under this section an office copy thereof shall be filed with the registrar of companies within seven days after the making of the order, or within such further time as the court may allow, and the resolution shall not take effect until such a copy has been so filed

Prior to the Companies Act, 1907, in which this section was first enacted, no power existed enabling the Company to alter the preferential rights of any class of Shareholders, where such rights were defined in the Memorandum, and no power was given therein to modify such rights.

Such alteration, however, can now be made subject to the provisions of the above section; but the sanction of the Court must be obtained, and will not be granted unless the proposed alteration is *bonâ fide*, and in the general interest.

§ 11.—Reduction of Share Capital.

46.—(1) Subject to confirmation by the court, a company limited by shares, if so authorised by its articles may by special resolution reduce its share capital in any way, and in particular (without prejudice to the generality of the foregoing power) may—

- (a) Extinguish or reduce the liability on any of its shares in respect of share capital not paid up; or
- (b) Either with or without extinguishing or reducing liability on any of its shares, cancel any paid up share capital which is lost or unrepresented by available assets; or
- (c) Either with or without extinguishing or reducing liability on any of its shares, pay off any paid up share capital which is in excess of the wants of the company.

and may, if and so far as is necessary, alter its memorandum by reducing the amount of its share capital and of its shares accordingly.

(2) A special resolution under this section is in this Act called a resolution for reducing share capital.

47. Where a company has passed and confirmed a resolution for reducing share capital it may apply by petition to the court for an order confirming the reduction.

Power must be taken in the Articles to reduce Capital, and if not so taken the Articles must first be altered by Special Resolution, and subsequently another Special Resolution must be passed reducing the Capital. It should be noted that the section provides that, subject to confirmation by the Court, a Company may reduce its Share Capital *in any way*, and not only in the authorised manners particularly described by the section. An arrangement by which Capital moneys are to be returned to one member only of the Company may be confirmed by the Court as a reduction, if it is equitable. (*The British and American Trustee Corporation v. Couper*, 1894, A.C. 399.)

It was at one time thought that it was necessary to show that the Capital was either lost, or unrepresented by available assets, or in excess of the wants of the Company. In *Barrow Haematite Co.* (1900,

2 Ch. 846), the Court refused to sanction a scheme which included the reduction of Preference Capital, on the ground that the Company could continue to pay dividends; but the Court of Appeal, while confirming the decision, indicated that the fact that the Company was able to continue to pay dividends was not in itself a good reason for refusing to sanction a scheme of reduction (1901, 2 Ch. 746); but it should be remembered that this particular Company had previously reduced its Preference Capital (1888, 39 Ch. D. 582).

In *Hoare & Co., Ltd* (1904, 2 Ch. 208), a scheme of reduction was sanctioned, although there was a reserve which had been employed in the business, and the loss was apportioned rateably between the Capital and the Reserve. The House of Lords confirmed this point of view in *Poole v. National Bank of China, Ltd.* (1907, A.C. 229).

Lord Macnaghten then said that when the rights of creditors did not intervene, "the only questions . . . to be considered are (1) Ought the Court to refuse its sanction to the reduction, out of regard to the interests of those members of the public who may be induced to take shares in the Company? and (2) Is the reduction fair and equitable as between the different classes of Shareholders?"

Where there are preferential classes of shares it is usual to arrange a scheme of compromise between the various classes of Shareholders. Where there are Preference Shares having no preference as to Capital, sanction will not be given to a reduction which reduces the Ordinary Shares without reducing the Preference Shares, unless the Ordinary Shareholders fully understand and consent to the scheme (*Union Plate Glass*).

Co., 1889, 42 Ch. D. 516). If the Preference Shares have a preference as to Capital, the loss should, in the absence of consent on the part of the Preference Shareholders, fall entirely on the Ordinary Shareholders. (*Agricultural Hotel Co.*, 1891, 1 Ch. 396; *Floating Dock Co. of St. Thomas*, 1895, 1 Ch. 691.) The loss occasioned by a reduction in respect of a loss of Capital should fall on those Shareholders who would have to bear it in the event of winding-up. (*London & New York Investment Corporation*, 1895, 2 Ch. 860.)

A Company cannot reduce its Capital by purchasing its own shares, and a power in the Articles of Association of the Company to do this is void. (*Trevor v. Whitworth*, 12 A.C. 409.)

Shares can be forfeited if there is authority in the Articles to do so, and a surrender of shares may be accepted in cases where the Directors have power to forfeit (*Bellamy v. Rowland & Marwoods S.S. Co.*, 1902, 2 Ch. 114). Each case of surrender must be determined upon its merits, but the sanction of the Court must be obtained, except where the surrender is in lieu of forfeiture.

A surrender of partly-paid shares in consideration of the release by the Company of the liability in respect of them is *ultra vires*, as in effect constituting the purchase by the Company of the shares in question, and the surrender in consideration of money or other shares is *ultra vires*.

Sections 48-53 provide the machinery for proceeding in these cases, and for the settlement of objections by Creditors, who, however, are only entitled to object if any diminution of liability or any repayment of Capital is involved, or where the Court so directs.

48. On and from the confirmation by a company of a resolution for reducing share capital, or where the reduction does not involve either the diminution of any liability in respect of unpaid share capital or the payment to any shareholder of any paid up share capital, then on and from the presentation of the petition for confirming the reduction, the company shall add to its name until such date as the court may fix, the words "and reduced" as the last words in its name, and those words shall until that date be deemed to be part of the name of the company.

Provided that, where the reduction does not involve either the diminution of any liability in respect of unpaid share capital or the payment to any shareholder of any paid up share capital, the court may, if it thinks expedient, dispense altogether with the addition of the words 'and reduced.'

49.- (1) Where the proposed reduction of share capital involves either diminution of liability in respect of unpaid share capital or the payment to any shareholder of any paid up share capital, and in any other case if the court so directs every creditor of the company who at the date fixed by the court is entitled to any debt or claim which, if that date were the commencement of the winding up of the company, would be admissible in proof against the company, shall be entitled to object to the reduction.

(2) The court shall settle a list of creditors so entitled to object, and for that purpose shall ascertain, as far as possible without requiring an application from any creditor the names of those creditors and the nature and amount of their debts or claims and may publish notices fixing a day or days within which creditors not entered on the list are to claim to be so entered or are to be excluded from the right of objecting to the reduction.

(3) Where a creditor entered on the list whose debt or claim is not discharged or determined does not consent to the reduction, the court may, if it thinks fit, dispense with the consent of that creditor, on the company securing payment of his debt or claim by appropriating, as the court may direct, the following amount, (that is to say,)—

- (i) If the company admits the full amount of his debt or claim, or, though not admitting it, is willing to provide for it, then the full amount of the debt or claim,
- (ii) If the company does not admit or is not willing to provide for the full amount of the debt or claim, or if the amount is contingent or not ascertained, then an amount fixed by the court after the like inquiry and adjudication as if the company were being wound up by the court.

50. The court, if satisfied, with respect to every creditor of the company who under this Act is entitled to object to the reduction, that either his consent to the reduction has been obtained or his debt or claim has been discharged or has determined, or has been secured, may make an order confirming the reduction on such terms and conditions as it thinks fit.

51.—(1) The registrar of companies on production to him of an order of the court confirming the reduction of the share capital of a company, and the delivery to him of a copy of the order and of a minute (approved by the court), showing with respect to the share capital of the company, as altered by the order, the amount of the share capital, the number of shares into which it is to be divided, and the amount of each share, and the amount (if any) at the date of the registration deemed to be paid up on each share, shall register the order and minute.

(2) On the registration, and not before, the resolution for reducing share capital as confirmed by the order so registered shall take effect.

(3) Notice of the registration shall be published in such manner as the court may direct.

(4) The registrar shall certify under his hand the registration of the order and minute, and his certificate shall be conclusive evidence that all the requirements of this Act with respect to reduction of share capital have been complied with, and that the share capital of the company is such as is stated in the minute.

52.—(1) The minute when registered shall be deemed to be substituted for the corresponding part of the memorandum of the company, and shall be valid and alterable as if it had been originally contained therein; and must be embodied in every copy of the memorandum issued after its registration.

(2) If a company makes default in complying with the requirements of this section it shall be liable to a fine not exceeding one pound for each copy in respect of which default is made, and every director and manager of the company who knowingly and wilfully authorises or permits the default shall be liable to the like penalty.

53. A member of the company, past or present, shall not be liable in respect of any share to any call or contribution exceeding in amount the difference (if any) between the amount paid, or (as the case may be) the reduced amount, if any, which is to be deemed to have been paid, on the share and the amount of the share as fixed by the minute:

Provided that if any creditor, entitled in respect of any debt or claim to object to the reduction of share capital, is, by reason of his ignorance of the proceedings for reduction, or of their nature and effect with respect to his claim, not entered on the list of creditors, and, after the reduction, the company is unable, within the meaning of the provisions of this Act with respect to winding up by the court, to pay the amount of his debt or claim, then --

(i) every person who was a member of the company at the date of the registration of the order for reduction and minute, shall be liable to contribute for the payment of that debt or claim an amount not exceeding the amount which he would have been liable to contribute if the company had commenced to be wound up on the day before that registration; and

(ii) if the company is wound up, the court, on the application of any such creditor, and proof of his ignorance as aforesaid may,

if he thinks fit, settle accordingly a list of persons so liable to contribute, and make and enforce calls and orders on the contributories settled on the list as if they were ordinary contributories in a winding up

Nothing in this section shall affect the rights of the contributories among themselves

§ 12.—Creation of Reserve Liability.

59. A limited company may by special resolution determine that any portion of its share capital which has not been already called up shall not be capable of being called up except in the event and for the purposes of the company being wound up and thereupon that portion of its share capital shall not be capable of being called up except in the event and for the purposes aforesaid

Once a Reserve Liability has been created, it cannot apparently be afterwards affected by any subsequent Special Resolution, as its creation effects an alteration in the Memorandum, and there is no power to recall the alteration. Reserve Capital cannot be included in a charge on the Uncalled Capital of a Company (*Bartlett v. Mayfair Property Co.*, 1898, 2 Ch. 28).

In considering whether a Company is insolvent for the purpose of a Winding-up Order, Unpaid Capital should be considered as an Asset, but Reserve Capital which cannot be called up except in the event of Winding-up cannot be taken into account (*Bristol Joint Stock Bank*, 1890, 44 Ch. D. 703).

§ 13.—Unlimited Liability of Directors.

60.—(1) In a limited company the liability of the directors or managers, or of the managing director, may, if so provided by the memorandum, be unlimited

61.—(1) A limited company, if so authorised by its articles, may, by special resolution, alter its memorandum so as to render unlimited the liability of its directors, or managers, or of any managing director,

§ 14.—First Statutory Meeting.

65.—(1) Every company limited by shares and registered on or after the first day of January nineteen hundred and one shall, within a period of not less than one month nor more than three months from the date at which the company is entitled to commence business, hold a general meeting of the members of the company which shall be called the statutory meeting

(2) The directors shall, at least seven days before the day on which the meeting is held, forward a report (in this Act called "the statutory report") to every member of the company and to every other person entitled under this Act to receive it

(3) The statutory report shall be certified by not less than two directors of the company, or, where there are less than two directors, by the sole director and manager, and shall state—

(a) the total number of shares allotted, distinguishing shares allotted as fully or partly paid up otherwise than in cash, and stating in the case of shares partly paid up the extent to which they are so paid up, and in either case the consideration for which they have been allotted

(b) the total amount of cash received by the company in respect of all the shares allotted, distinguished as aforesaid,

(c) an abstract of the receipts of the company on account of its capital, whether from shares or debentures, and of the payments made thereout, up to a date within seven days of the date of the report, exhibiting under distinctive headings the receipts of the company from shares and debentures and other sources, the payments made thereout, and particulars concerning the balance remaining in hand, and an account or estimate of the preliminary expenses of the company,

(d) the names, addresses, and descriptions of the directors, auditors (if any), managers (if any), and secretary of the company; and

(e) the particulars of any contract, the modification of which is to be submitted to the meeting for its approval together with the particulars of the modification or proposed modification.

(4) The statutory report shall, so far as it relates to the shares allotted by the company, and to the cash received in respect of such shares, and to the receipts and payments of the company on capital account, be certified as correct by the auditors, if any, of the company

(5) The directors shall cause a copy of the statutory report, certified as by this section required, to be filed with the registrar of companies forthwith after the sending thereof to the members of the company.

(6) The directors shall cause a list showing the names, descriptions and addresses of the members of the company, and the number of shares held by them respectively to be produced at the commencement of the meeting, and to remain open and accessible to any member of the company during the continuance of the meeting

(7) The members of the company present at the meeting shall be at liberty to discuss any matter relating to the formation of the company.

or arising out of the statutory report, whether previous notice has been given or not, but no resolution of which notice has not been given in accordance with the articles may be passed

(8) The meeting may adjourn from time to time, and at any adjourned meeting any resolution of which notice has been given in accordance with the articles, either before or subsequently to the former meeting, may be passed, and the adjourned meeting shall have the same powers as an original meeting

(9) If a petition is presented to the court in manner provided by Part IV of this Act for winding up the company on the ground of default in filing the statutory report or in holding the statutory meeting, the court may, instead of directing that the company be wound up, give directions for the statutory report to be filed or a meeting to be held, or make such other order as may be just

(10) The provisions of this section as to the forwarding and filing of the statutory report shall not apply in the case of a private company

The Statutory Report must be forwarded to every member and Debenture-holder of a Public Company registered after the 30th June, 1908, as provided for in § 114. A Private Company need not forward the Report to the members or Debenture holders, or file it with the Registrar of Companies, and the provisions as to the Statutory Report do not apply, but it must hold the Statutory Meeting, the objects of which must be gathered from sub sections 6, 7 and 8 of § 65 (*Gardner v. Iredale*, 1912, L.J. (Ch. 531).)

The duties of the Auditors in connection with that part of the Report, which it is their duty to certify ~~if~~ they are appointed before the Statutory Meeting, are fully dealt with in Chapter IX. § 7.

Under § 83 a Company may not vary the terms of a contract referred to in the prospectus or statement in lieu of a prospectus prior to the Statutory Meeting, except subject to the approval of such Meeting.

§ 15.—Annual General Meeting.

84.—(1) A general meeting of every company shall be held once at the least in every calendar year, and not more than fifteen months after the holding of the last preceding general meeting, and, if not so

held, the company and every director, manager, secretary, and other officer of the company, who is knowingly a party to the default, shall be liable to a fine not exceeding fifty pounds.

(2) When default has been made in holding a meeting of the company in accordance with the provisions of this section, the court may, on the application of any member of the company, call or direct the calling of a general meeting of the company.

Prior to the Companies Act, 1907, a Company was only required to hold a General Meeting once at least in every year, and it was possible for a period of 23 months to elapse between the holding of one Meeting and another. This is not now possible, and the Meeting must be held not more than 15 months after the last Meeting.

§ 16.—Extraordinary General Meeting.

66.—(1) Notwithstanding anything in the articles of a company, the directors of a company shall, on the requisition of the holders of not less than one-tenth of the issued share capital of the company upon which all calls or other sums then due have been paid, forthwith proceed to convene an extraordinary general meeting of the company.

(2) The requisition must state the objects of the meeting, and must be signed by the requisitionists and deposited at the registered office of the company, and may consist of several documents in like form, each signed by one or more requisitionists.

(3) If the directors do not proceed to cause a meeting to be held within twenty-one days from the date of the requisition being so deposited, the requisitionists, or a majority of them in value, may themselves convene the meeting, but any meeting so convened shall not be held after three months from the date of the deposit.

(4) If at any such meeting a resolution requiring confirmation at another meeting is passed, the directors shall forthwith convene a further extraordinary general meeting for the purpose of considering the resolution and, if thought fit, of confirming it as a special resolution; and, if the directors do not convene the meeting within seven days from the date of the passing of the first resolution, the requisitionists, or a majority of them in value, may themselves convene the meeting.

(5) Any meeting convened under this section by the requisitionists shall be convened in the same manner, as nearly as possible, as that in which meetings are to be convened by directors.

§ 17.—Extraordinary and Special Resolutions.

69.—(1) A resolution shall be an extraordinary resolution when it has been passed by a majority of not less than three-fourths of such members entitled to vote as are present in person or by proxy (where proxies are allowed) at a general meeting of which notice specifying the intention to propose the resolution as an extraordinary resolution has been duly given.

(2) A resolution shall be a special resolution when it has been—

- (a) passed in manner required for the passing of an extraordinary resolution ; and
- (b) confirmed by a majority of such members entitled to vote as are present in person or by proxy (where proxies are allowed) at a subsequent general meeting, of which notice has been duly given, and held after an interval of not less than fourteen days, nor more than one month, from the date of the first meeting.

(3) At any meeting at which an extraordinary resolution is submitted to be passed or a special resolution is submitted to be passed or confirmed, a declaration of the chairman that the resolution is carried shall, unless a poll is demanded, be conclusive evidence of the fact without proof of the number or proportion of the votes recorded in favour of or against the resolution.

(4) At any meeting at which an extraordinary resolution is submitted to be passed or a special resolution is submitted to be passed or confirmed a poll may be demanded, if demanded by three persons for the time being entitled according to the articles to vote, unless the articles of the company require a demand by such number of such persons, not in any case exceeding five, as may be specified in the articles.

(5) When a poll is demanded in accordance with this section, in computing the majority on the poll reference shall be had to the number of votes to which each member is entitled by the articles of the company.

(6) For the purposes of this section notice of a meeting shall be deemed to be duly given and the meeting to be duly held when the notice is given and the meeting held in manner provided by the articles.

70.—(1) A copy of every special and extraordinary resolution shall within fifteen days from the confirmation of the special resolution, or from the passing of the extraordinary resolution, as the case may be, be printed and forwarded to the registrar of companies, who shall record the same.

(2) Where articles have been registered, a copy of every special resolution for the time being in force shall be embodied in or annexed to every copy of the articles issued after the confirmation of the resolution.

(3) Where articles have not been registered, a copy of every special resolution shall be forwarded in print to any member at his

request, on payment of one shilling or such less sum as the company may direct.

(4) If a company makes default in printing or forwarding a copy of a special or extraordinary resolution to the registrar it shall be liable to a fine not exceeding two pounds for every day during which the default continues.

(5) If a company makes default in embodying in or annexing to a copy of its articles or in forwarding in print to a member when required by this section a copy of a special resolution, it shall be liable to a fine not exceeding one pound for each copy in respect of which default is made.

(6) Every director and manager of a company who knowingly and wilfully authorises or permits any default by the company in complying with the requirements of this section shall be liable to the like penalty as is imposed by this section on the company for that default.

§ 18.—Minute Books.

71.—(1) Every company shall cause minutes of all proceedings of general meetings and (where there are directors or managers) of its directors or managers to be entered in books kept for that purpose.

(2) Any such minute if purporting to be signed by the chairman of the meeting at which the proceedings were had, or by the chairman of the next succeeding meeting, shall be evidence of the proceedings.

§ 19.—Appointment & Qualification of Directors.

72.—(1) A person shall not be capable of being appointed director of a company by the articles, and shall not be named as a director or proposed director of a company in any prospectus issued by or on behalf of the company, or in any statement in lieu of prospectus filed by or on behalf of a company, unless, before the registration of the articles or the publication of the prospectus, or the filing of the statement in lieu of prospectus, as the case may be, he has by himself or by his agent authorised in writing

- (i) Signed and filed with the registrar of companies a consent in writing to act as such director: and
- (ii) Either signed the memorandum for a number of shares not less than his qualification (if any), or signed and filed with the registrar a contract in writing to take from the company and pay for his qualification shares (if any).

(2) On the application for registration of the memorandum and articles of a company the applicant shall deliver to the registrar a list of the persons who have consented to be directors of the company, and, if this list contains the name of any person who has not so

consented, the applicant shall be liable to a fine not exceeding fifty pounds.

(3) This section shall not apply to a private company nor to a prospectus issued by or on behalf of a company after the expiration of one year from the date at which the company is entitled to commence business.

73. (1) Without prejudice to the restrictions imposed by the last foregoing section, it shall be the duty of every director who is by the regulations of the company required to hold a specified share qualification, and who is not already qualified, to obtain his qualification within two months after his appointment, or such shorter time as may be fixed by the regulations of the company

(2) The office of director of a company shall be vacated if the director does not within two months from the date of his appointment, or within such shorter time as may be fixed by the regulations of the company, obtain his qualification, or if after the expiration of such period or shorter time he ceases at any time to hold his qualification, and a person vacating office under this section shall be incapable of being re-appointed director of the company until he has obtained his qualification

(3) If after the expiration of the said period or shorter time any unqualified person acts as a director of the company, he shall be liable to a fine not exceeding five pounds for every day between the expiration of the said period or shorter time and the last day on which it is proved that he acted as a director

74.—The acts of a director or manager shall be valid notwithstanding any defect that may afterwards be discovered in his appointment or qualification

Unless the Articles provide, a Director need not hold any qualification. Under § 37 (4) the holding of Share Warrants is not strictly a qualification, as these are transmissible by bearer.

§ 20.—Register of Directors.

75.—(1) Every company shall keep at its registered office a register containing the names and addresses and the occupations of its directors or managers, and send to the registrar of companies a copy thereof, and from time to time notify to the registrar any change among its directors or managers.

(2) If default is made in compliance with this section, the company shall be liable to a fine not exceeding five pounds for every day during which the default continues; and every director and manager of the company who knowingly and wilfully authorises or permits the default shall be liable to the like penalty.

§ 21.—The Prospectus.

80.—(1) Every prospectus issued by or on behalf of a company or in relation to any intended company shall be dated, and that date shall, unless the contrary be proved, be taken as the date of publication of the prospectus.

(2) A copy of every such prospectus, signed by every person who is named therein as a director or proposed director of the company, or by his agent authorised in writing, shall be filed for registration with the registrar of companies on or before the date of its publication, and no such prospectus shall be issued until a copy thereof has been so filed for registration.

(3) The registrar shall not register any prospectus unless it is dated, and the copy thereof signed, in manner required by this section.

(4) Every prospectus shall state on the face of it that a copy has been filed for registration as required by this section.

(5) If a prospectus is issued without a copy thereof being so filed, the company, and every person who is knowingly a party to the issue of the prospectus, shall be liable to a fine not exceeding five pounds for every day from the date of the issue of the prospectus until a copy thereof is so filed.

81.—(1) Every prospectus issued by or on behalf of a company, or by or on behalf of any person who is or has been engaged or interested in the formation of the company, must state—

- (a) the contents of the memorandum, with the names, descriptions, and addresses of the signatories, and the number of shares subscribed for by them respectively; and the number of founders or management or deferred shares, if any, and the nature and extent of the interest of the holders in the property and profits of the company; and
- (b) the number of shares, if any, fixed by the articles as qualification as a director, and any provision in the articles as to the remuneration of the directors; and
- (c) the names, descriptions, and addresses of the directors or proposed directors; and
- (d) the minimum subscription on which the directors may proceed to allotment, and the amount payable on application and allotment on each share; and in the case of a second or subsequent offer of shares, the amount offered for subscription on each previous allotment made within the two preceding years, and the amount actually allotted, and the amount, if any, paid on the shares so allotted; and
- (e) the number and amount of shares and debentures which within the two preceding years have been issued, or agreed to be issued, as fully or partly paid up otherwise than in cash, and in the latter case the extent to which they are so paid up, and in either case the consideration for which those shares or debentures have been issued or are proposed or intended to be issued; and

- (f) the names and addresses of the vendors of any property purchased or acquired by the company, or proposed so to be purchased or acquired, which is to be paid for wholly or partly out of the proceeds of the issue offered for subscription by the prospectus or the purchase or acquisition of which has not been completed at the date of issue of the prospectus, and the amount payable in cash, shares, or debentures to the vendor, and where there is more than one separate vendor, or the company is a sub-purchaser, the amount so payable to each vendor. Provided that where the vendors or any of them are a firm the members of the firm shall not be treated as separate vendors, and
- (g) the amount (if any) paid or payable as purchase money in cash, shares, or debentures for any such property as aforesaid, specifying the amount (if any) payable for goodwill, and
- (h) the amount (if any) paid within the two preceding years, or payable as commission for subscribing or agreeing to subscribe, or procuring or agreeing to procure subscriptions for any shares in, or debentures of, the company, or the rate of any such commission. Provided that it shall not be necessary to state the commission payable to sub-underwriters, and
- (i) the amount or estimated amount of preliminary expenses, and
- (j) the amount paid within the two preceding years or intended to be paid to any promoter and the consideration for any such payment and
- (k) the dates of and parties to every material contract, and a reasonable time and place at which any material contract or a copy thereof may be inspected. Provided that this requirement shall not apply to a contract entered into in the ordinary course of the business carried on or intended to be carried on by the company, or to any contract entered into more than two years before the date of issue of the prospectus: and
- (l) the names and addresses of the auditors (if any) of the company; and
- (m) full particulars of the nature and extent of the interest (if any) of every director in the promotion of, or in the property proposed to be acquired by, the company, or, where the interest of such a director consists in being a partner in a firm, the nature and extent of the interest of the firm, with a statement of all sums paid or agreed to be paid to him or to the firm in cash or shares or otherwise by any person either to induce him to become, or to qualify him as, a director, or, otherwise for services rendered by him or by the firm in connexion with the promotion or formation of the Company; and
- (n) where the company is a company having shares of more than one class, the right of voting at meetings of the company conferred by the several classes of shares respectively.

(2) For the purposes of this section every person shall be deemed to be a vendor who has entered into any contract, absolute or conditional, for the sale or purchase, or for any option of purchase, of any property to be acquired by the company, in any case where—

- (a) the purchase money is not fully paid at the date of issue of the prospectus; or
- (b) the purchase money is to be paid or satisfied wholly or in part out of the proceeds of the issue offered for subscription by the prospectus; or
- (c) the contract depends for its validity or fulfilment on the result of that issue.

(3) Where any of the property to be acquired by the company is to be taken on lease, this section shall apply as if the expression "vendor" included the lessor, and the expression "purchase money" included the consideration for the lease, and the expression "sub-purchaser" included a sub-lessee.

(4) Any condition requiring or binding any applicant for shares or debentures to waive compliance with any requirement of this section, or purporting to affect him with notice of any contract, document, or matter not specifically referred to in the prospectus, shall be void.

(5) Where any such prospectus as is mentioned in this section is published as a newspaper advertisement, it shall not be necessary in the advertisement to specify the contents of the memorandum or the signatories thereto, and the number of shares subscribed for by them.

(6) In the event of non-compliance with any of the requirements of this section, a director or other person responsible for the prospectus shall not incur any liability by reason of the non-compliance, if he proves that—

- (a) as regards any matter not disclosed, he was not cognisant thereof; or
- (b) the non-compliance arose from an honest mistake of fact on his part:

Provided that in the event of non-compliance with the requirements contained in paragraph (m) of sub-section (1) of this section no director or other person shall incur any liability in respect of the non-compliance unless it be proved that he had knowledge of the matters not disclosed.

(7) This section shall not apply to a circular or notice inviting existing members or debenture-holders of a company to subscribe either for shares or for debentures of the company, whether with or without the right to renounce in favour of other persons, but subject as aforesaid, this section shall apply to any prospectus whether issued on or with reference to the formation of a company or subsequently.

(8) The requirements of this section as to the memorandum and the qualification, remuneration, and interest of directors, the names, descriptions, and addresses of directors or proposed directors, and

the amount or estimated amount of preliminary expenses, shall not apply in the case of a prospectus issued more than one year after the date at which the company is entitled to commence business.

(9) Nothing in this section shall limit or diminish any liability which any person may incur under the general law or this Act apart from this section.

A Prospectus is defined under § 285 as meaning any Prospectus, Notice, Circular, Advertisement, or other invitation offering to the Public for subscription or purchase any shares or debentures of the Company.

An Auditor should not permit his name to appear on any Prospectus as Auditor of the Company without first having seen and approved a draft of the Prospectus.

§ 22.—Statement in lieu of Prospectus.

82.—(1) A company which does not issue a prospectus on or with reference to its formation, shall not allot any of its shares or debentures unless before the first allotment of either shares or debentures there has been filed with the registrar of companies a statement in lieu of prospectus signed by every person who is named therein as a director or a proposed director of the company, or by his agent authorised in writing, in the form and containing the particulars set out in the Second Schedule to this Act.

(2) This section shall not apply to a private company or to a company which has allotted any shares or debentures before the first day of July nineteen hundred and eight.

§ 23.—Liability for Statements in Prospectus.

84.—(1) Where a prospectus invites persons to subscribe for shares in or debentures of a company, every person who is a director of the company at the time of the issue of the prospectus, and every person who has authorised the naming of him and is named in the prospectus as a director or as having agreed to become a director either immediately or after an interval of time, and every promoter of the company, and every person who has authorised the issue of the prospectus, shall be liable to pay compensation to all persons who subscribe for any shares or debentures on the faith of the prospectus for the loss or damage they may have sustained by reason of any untrue statement therein, or in any report or memorandum appearing

on the face thereof, or by reference incorporated therein or issued therewith, unless it is proved—

- (a) With respect to every untrue statement not purporting to be made on the authority of an expert, or of a public official document or statement, that he had reasonable ground to believe, and did up to the time of the allotment of the shares or debentures, as the case may be, believe, that the statement was true; and
- (b) with respect to every untrue statement purporting to be a statement by or contained in what purports to be a copy of or extract from a report or valuation of an expert, that it fairly represented the statement, or was a correct and fair copy of or extract from the report or valuation. Provided that the director, person named as director, promoter, or person who authorised the issue of the prospectus, shall be liable to pay compensation as aforesaid, if it is proved that he had no reasonable ground to believe that the person making the statement, report, or valuation was competent to make it; and
- (c) with respect to every untrue statement purporting to be a statement made by an official person or contained in what purports to be a copy of or extract from a public official document, that it was a correct and fair representation of the statement or copy of, or extract from the document:

or unless it is proved—

- (i) that having consented to become a director of the company he withdrew his consent before the issue of the prospectus, and that it was issued without his authority or consent; or
- (ii) that the prospectus was issued without his knowledge or consent, and that on becoming aware of its issue he forthwith gave reasonable public notice that it was issued without his knowledge or consent; or
- (iii) that after the issue of the prospectus and before allotment thereunder, he, on becoming aware of any untrue statement therein, withdrew his consent thereto, and gave reasonable public notice of the withdrawal, and of the reason therefor.

(2) Where a company existing on the eighteenth day of August one thousand eight hundred and ninety, has issued shares or debentures, and for the purpose of obtaining further capital by subscriptions for shares or debentures issues a prospectus, a director shall not be liable in respect of any statement therein, unless he has authorised the issue of the prospectus, or has adopted or ratified it.

(3) Where the prospectus contains the name of a person as a director of the company, or as having agreed to become a director thereof, and he has not consented to become a director, or has withdrawn his consent before the issue of the prospectus, and has not authorised or consented to the issue thereof, the directors of the company, except any without whose knowledge or consent the prospectus was

issued, and any other person who authorised the issue thereof, shall be liable to indemnify the person named as aforesaid against all damages, costs, and expenses to which he may be made liable by reason of his name having been inserted in the prospectus, or in defending himself against any action or legal proceedings brought against him in respect thereof.

(4) Every person who by reason of his being a director, or named as a director or as having agreed to become a director, or of his having authorised the issue of the prospectus, becomes liable to make any payment under this section may recover contribution, as in cases of contract, from any other person who, if sued separately, would have been liable to make the same payment, unless the person who has become so liable was and that other person was not, guilty of fraudulent misrepresentation on his part.

(5) Any condition requiring, or binding any applicant for shares, to waive compliance with any requirement of this section shall be void.

(6) This section, except sub section (3) thereof, shall not apply to any allotment of shares subsequent to the first allotment of shares offered to the public for subscription.

The expression "expert" includes engineer, valuer, accountant, and any other person whose profession gives authority to a statement made by him.

If the misrepresentation is contained in the Report of an Accountant, and it can be proved that such misrepresentation is fraudulent, or is occasioned by negligence on the part of the Accountant, he will be liable to damages. .

An Auditor, named in a Prospectus, who conducts himself so as to become a promoter, or who directly authorises the issue thereof, might find himself liable under this section; but, according to the opinion of Counsel obtained by the Council of the Institute of Chartered Accountants an Auditor does not authorise the issue of a Prospectus or Notice within the meaning of the Act by merely permitting his name to be mentioned in the Prospectus or Notice as Auditor; or by merely permitting a professional Report made by him to be referred to in it; or by merely preparing or advising upon it, or assisting in its preparation professionally.

§ 24.—Allotment of Shares.

85.—(1) No allotment shall be made of any share capital of a company offered to the public for subscription, unless the following conditions have been complied with, namely :—

- (a) the amount (if any) fixed by the memorandum or articles and named in the prospectus as the minimum subscription upon which the directors may proceed to allotment; or
- (b) if no amount is so fixed and named, then the whole amount of the share capital so offered for subscription,

has been subscribed, and the sum payable on application for the amount so fixed and named, or for the whole amount offered for subscription, has been paid to and received by the company.

(2) The amount so fixed and named and the whole amount aforesaid shall be reckoned exclusively of any amount payable otherwise than in cash, and is in this Act referred to as the minimum subscription.

(3) The amount payable on application on each share shall not be less than five per cent. of the nominal amount of the share.

(4) If the conditions aforesaid have not been complied with on the expiration of forty days after the first issue of the prospectus, all money received from applicants for shares shall be forthwith repaid to them without interest, and, if any such money is not so repaid within forty-eight days after the issue of the prospectus, the directors of the company shall be jointly and severally liable to repay that money with interest at the rate of five per centum per annum from the expiration of the forty-eighth day :

Provided that a director shall not be liable if he proves that the loss of the money was not due to any misconduct or negligence on his part.

(5) Any condition requiring or binding any applicant for shares to waive compliance with any requirement of this section shall be void.

(6) This section, except subsection (3) thereof, shall not apply to any allotment of shares subsequent to the first allotment of shares offered to the public for subscription.

(7) In the case of the first allotment of share capital payable in cash of a company which does not issue any invitation to the public to subscribe for its shares, no allotment shall be made unless the minimum subscription (that is to say) :—

- (a) the amount (if any) fixed by the memorandum or articles and named in the statement in lieu of prospectus as the minimum subscription upon which the directors may proceed to allotment; or
- (b) if no amount is so fixed and named, then the whole amount of the share capital other than that issued or agreed to be

issued as fully or partly paid up otherwise than in cash, has been subscribed and an amount not less than five per cent. of the nominal amount of each share payable in cash has been paid to and received by the company.

This subsection shall not apply to a private company or to a company which has allotted any shares or debentures before the first day of July nineteen hundred and eight

86. —(1) An allotment made by a company to an applicant in contravention of the provisions of the last foregoing section shall be voidable at the instance of the applicant within one month after the holding of the statutory meeting of the company and not later, and shall be so voidable notwithstanding that the company is in course of being wound up

(2) If any director of a company knowingly contravenes or permits or authorises the contravention of any of the provisions of the last foregoing section with respect to allotment he shall be liable to compensate the company and the allottee respectively for any loss, damages, or costs which the company or the allottee may have sustained or incurred thereby. Provided that proceedings to recover any such loss, damages, or costs shall not be commenced after the expiration of two years from the date of the allotment.

The Minimum Subscription may be fixed by the Articles, but not less than 5 per cent. of the nominal amount of each share must be paid to and received by the Company, before the Directors proceed to allotment. Such amounts must actually be received in cash. Cheques received before allotment, and dishonoured after allotment, are not regarded as payment within the meaning of the section (*Mears v. Western of Canada Pulp Co.*, 1905, 2 Ch. 353); similarly cheques received prior to allotment, but not passed through the Company's Bank till after allotment, do not constitute payment, even although they may be honoured in due course. (*National Motor Mail Coaching Co.*, 1908, 2 Ch. 228.)

§ 25. -Restrictions on Commencement of Business.

87.—(1) A company shall not commence any business or exercise any borrowing powers unless—

(a) shares held subject to the payment of the whole amount thereof in cash have been allotted to an amount not less in the whole than the minimum subscription; and

- (b) every director of the company has paid to the company on each of the shares taken or contracted to be taken by him, and for which he is liable to pay in cash, a proportion equal to the proportion payable on application and allotment, on the shares offered for public subscription, or in the case of a company which does not issue a prospectus inviting the public to subscribe for its shares, on the shares payable in cash; and
- (c) there has been filed with the registrar of companies a statutory declaration by the secretary or one of the directors, in the prescribed form, that the aforesaid conditions have been complied with; and
- (d) in the case of a company which does not issue a prospectus inviting the public to subscribe for its shares, there has been filed with the registrar of companies a statement in lieu of prospectus.

(2) The registrar of companies shall, on the filing of this statutory declaration, certify that the company is entitled to commence business, and that certificate shall be conclusive evidence that the company is so entitled:

Provided that in the case of a company which does not issue a prospectus inviting the public to subscribe for its shares the registrar shall not give such a certificate unless a statement in lieu of prospectus has been filed with him.

(3) Any contract made by a company before the date at which it is entitled to commence business shall be provisional only, and shall not be binding on the company until that date, and on that date it shall become binding.

(4) Nothing in this section shall prevent the simultaneous offer for subscription or allotment of any shares and debentures or the receipt of any money payable on application for debentures.

(5) If any company commences business or exercises borrowing powers in contravention of this section, every person who is responsible for the contravention shall, without prejudice to any other liability, be liable to a fine not exceeding fifty pounds for every day during which the contravention continues.

(6) Nothing in this section shall apply to a private company, or to a company registered before the first day of January nineteen hundred and one, or to a company registered before the first day of July nineteen hundred and eight which does not issue a prospectus inviting the public to subscribe for its shares.

§ 26.—Return of Allotments.

88.—(1) Whenever a company limited by shares makes any allotment of its shares, the company shall within one month thereafter file with the registrar of companies—

- (a) a return of the allotments, stating the number and nominal amount of the shares comprised in the allotment, the names,

addresses, and descriptions of the allottees, and the amount (if any) paid or due and payable on each share ; and

- (b) in the case of shares allotted as fully or partly paid up otherwise than in cash, a contract in writing constituting the title of the allottee to the allotment together with any contract of sale, or for services or other consideration in respect of which that allotment was made, such contracts being duly stamped, and a return stating the number and nominal amount of shares so allotted, the extent to which they are to be treated as paid up, and the consideration for which they have been allotted!

(2) Where such a contract as above mentioned is not reduced to writing, the company shall within one month after the allotment file with the registrar of companies the prescribed particulars of the contract stamped with the same stamp duty as would have been payable if the contract had been reduced to writing, and those particulars shall be deemed to be an instrument within the meaning of the Stamp Act, 1891, and the registrar may, as a condition of filing the particulars, require that the duty payable thereon be adjudicated under section twelve of that Act

(3) If default is made in complying with the requirements of this section, every director, manager, secretary, or other officer of the company, who is knowingly a party to the default, shall be liable to a fine not exceeding fifty pounds for every day during which the default continues :

Provided that, in case of default in filing with the registrar of companies within one month after the allotment any document required to be filed by this section, the company, or any person liable for the default, may apply to the court for relief, and the court, if satisfied that the omission to file the document was accidental or due to inadvertence or that it is just and equitable to grant relief, may make an order extending the time for the filing of the document for such period as the court may think proper.

Prior to the Companies Act, 1900, where no contract was filed in respect of shares issued other than for cash, the Allottee was liable to pay for the whole amount of the shares in cash.

This provision, however, was repealed by the Companies Act, 1900, and the only effect of non-registration of a Contract is the penalty of £50 a day referred to in the above section. The actual title of the Allottee is not affected as long as the Contract is good.

Where the shares are allotted to the Nominees of the Vendors, unless provision is made for this in the

original Contract, either a supplementary Contract should be filed, constituting the title to allotment, or a nomination by the Vendor in favour of his Nominees.

§ 27.—Commissions and Discounts.

89.—(1) It shall be lawful for a company to pay a commission to any person in consideration of his subscribing or agreeing to subscribe, whether absolutely or conditionally, for any shares in the company, or procuring or agreeing to procure subscriptions, whether absolute or conditional, for any shares in the company, if the payment of the commission is authorised by the articles, and the commission paid or agreed to be paid does not exceed the amount or rate so authorised, and if the amount or rate per cent of the commission paid or agreed to be paid is

- (a) In the case of shares offered to the public for subscription, disclosed in the prospectus ; or
- (b) In the case of shares not offered to the public for subscription, disclosed in the statement in lieu of prospectus, or in a statement in the prescribed form signed in like manner as a statement in lieu of prospectus and filed with the registrar of companies, and, where a circular or notice, not being a prospectus, inviting subscription for the shares is issued, also disclosed in that circular or notice.

(2) Save as aforesaid, no company shall apply any of its shares or capital money either directly or indirectly in payment of any commission, discount, or allowance, to any person in consideration of his subscribing or agreeing to subscribe, whether absolutely or conditionally, for any shares of the company, or procuring or agreeing to procure subscriptions, whether absolute or conditional, for any shares in the company, whether the shares or money be so applied by being added to the purchase money of any property acquired by the company or to the contract price of any work to be executed for the company, or the money be paid out of the nominal purchase money or contract price, or otherwise.

(3) Nothing in this section shall affect the power of any company to pay such brokerage as it has heretofore been lawful for a company to pay, and a vendor to, promoter of, or other person who receives payment in money or shares from, a company shall have and shall be deemed always to have had power to apply any part of the money or shares so received in payment of any commission the payment of which, if made directly by the company, would have been legal under this section.

90. Where a company has paid any sums by way of commission in respect of any shares or debentures, or allowed any sums by way

of discount in respect of any debentures, the total amount so paid or allowed, or so much thereof as has not been written off, shall be stated in every balance sheet of the company until the whole amount thereof has been written off

All Companies, whether Public or Private, are now empowered to pay Underwriting Commission, if the provisions of this clause are complied with, whether the shares are to be offered to the Public or not.

Shares may not be issued at a discount (*Ooregum Gold Co. v. Roper*, 1892, A.C. 125), but no limit is placed upon the amount of Underwriting Commission that can be paid, provided this section is complied with; and the effect, as far as the Company is concerned, is practically the same as if it had power to issue Shares at a discount. An agreement that Debentures issued at a discount may subsequently be exchanged for fully-paid Shares is void, as this would have the effect of issuing such Shares at a discount. (*Moseley v. Koffysfontein Mines*, 1904, 2 Ch. 108.)

A Company is entitled to grant an option to an Underwriter to subscribe for further Shares at par within a certain period, notwithstanding that the Shares are standing at a price above par in the market. (*Hilder v. Dexter*, 1902, A.C. 474.) This power has of late years been extensively taken advantage of, and does not fall within the prohibition of sub-section (2) of the above section, which particularly provides against the concealed payment of Commission by adding the amount thereof to the purchase consideration.

It is not necessary for a Company to take power to pay the usual brokerage for placing Shares, which was lawful prior to the passing of this provision under *Metropolitan Coal Consumers' Association v. Scrimgeour* (1895, 2 Q.B. 604).

In addition to the disclosure in the Prospectus or Statement in lieu of the Prospectus under § 89, and the separate statement in the Balance Sheet under § 90, in the event of any commission being paid on the issue of Shares or Debentures, the total amount so paid, or the amount allowed by way of discount in respect of any Debentures, must be stated in the Annual Summary (§ 26) ; and as regards commissions or discounts on Debentures, the particulars must be registered with the Registrar of Companies under § 93.

§ 28. Payment of Interest out of Capital.

91. Where any shares of a company are issued for the purpose of raising money to defray the expenses of the construction of any works or buildings or the provision of any plant which cannot be made profitable for a lengthened period the company may pay interest on so much of that share capital as is for the time being paid up for the period and subject to the conditions and restrictions in this section mentioned, and may charge the same to capital as part of the cost of construction of the work or building, or the provision of plant.

Provided that

- (1) No such payment shall be made unless the same is authorised by the articles or by special resolution
- (2) No such payment, whether authorised by the articles or by special resolution, shall be made without the previous sanction of the Board of Trade
- (3) Before sanctioning any such payment the Board of Trade may, at the expense of the company, appoint a person to inquire and report to them as to the circumstances of the case, and may, before making the appointment, require the company to give security for the payment of the costs of the inquiry
- (4) The payment shall be made only for such period as may be determined by the Board of Trade, and such period shall in no case extend beyond the close of the half year next after the half year during which the works or buildings have been actually completed or the plant provided :
- (5) The rate of interest shall in no case exceed four per cent. per annum, or such lower rate as may for the time being be prescribed by Order in Council :

- (6) The payment of the interest shall not operate as a reduction of the amount paid up on the shares in respect of which it is paid
- (7) The accounts of the company shall show the share capital on which, and the rate at which, interest has been paid out of capital during the period to which the accounts relate
- (8) Nothing in this section shall affect any company to which the Indian Railways Act, 1894, is amended by any subsequent enactment, applies

The Indian Railways Act, 1894, provided for the payment of interest out of Capital during construction by Companies registered under the Companies Acts, and formed for the purpose of making and working, or making or working, a Railway in India.

§ 29. — Issue of Share and Debenture Certificates, &c.

92. —(1) Every company shall, within two months after the allotment of any of its shares, debentures or debenture stock, and within two months after the registration of the transfer of any such shares, debentures, or debenture stock, complete and have ready for delivery the certificates of all shares, the debentures, and the certificates of all debenture stock allotted or transferred, unless the conditions of issue of the shares, debentures, or debenture stock otherwise provide

(2) If default is made in complying with the requirements of this section, the company and every director, manager, secretary, and other officer of the company who is knowingly a party to the default, shall be liable to a fine not exceeding five pounds for every day during which the default continues

§ 30. — Registration of Mortgages and Charges.

93. —(1) Every mortgage or charge created after the first day of July nineteen hundred and eight by a company registered in England or Ireland and being either —

- (a) a mortgage or charge for the purpose of securing any issue of debentures, or
- (b) a mortgage or charge on uncalled share capital of the company; or
- (c) a mortgage or charge created or evidenced by an instrument which, if executed by an individual, would require registration as a bill of sale; or

- (d) a mortgage or charge on any land, wherever situate, or any interest therein ; or
- (e) a mortgage or charge on any book debts of the company ; or
- (f) a floating charge on the undertaking or property of the company,

shall, so far as any security on the company's property or undertaking is thereby conferred, be void against the liquidator and any creditor of the Company, unless the prescribed particulars of the mortgage or charge, together with the instrument (if any) by which the mortgage or charge is created or evidenced, are delivered to or received by the registrar of companies for registration in manner required by this Act, within twenty-one days after the date of its creation, but without prejudice to any contract or obligation for repayment of the money thereby secured, and when a mortgage or charge becomes void under this section the money secured thereby shall immediately become payable.

The remainder of this section prescribes the particulars to be furnished by the Company to the Registrar and the manner in which the same are to be recorded by him.

96. A judge of the High Court, on being satisfied that the omission to register a mortgage or charge within the time hereinbefore required, or that the omission or mis-statement of any particular with respect to any such mortgage or charge, was accidental, or due to inadvertence or to some other sufficient cause, or is not of a nature to prejudice the position of creditors or shareholders of the company, or that on other grounds it is just and equitable to grant relief, may, on the application of the company or any person interested, and on such terms and conditions as seem to the judge just and expedient, order that the time for registration be extended, or, as the case may be, that the omission or mis-statement be rectified.

99.—(1) If any company makes default in sending to the registrar of companies for registration the particulars of any mortgage or charge created by the company, and of the issues of debentures of a series, requiring registration with the registrar under the foregoing provisions of this Act, then, unless the registration has been effected on the application of some other person, the company, and every director, manager, secretary, or other person who is knowingly a party to the default, shall on conviction be liable to a fine not exceeding fifty pounds for every day during which the default continues.

(2) Subject as aforesaid, if any company makes default in complying with any of the requirements of this Act as to the registration with the registrar of any mortgage or charge created by the company, the company and every director, manager, and other officer of the company, who knowingly and wilfully authorised or permitted the default, shall, without prejudice to any other liability, be liable on summary conviction to a fine not exceeding one hundred pounds.

(3) If any person knowingly and wilfully authorises or permits the delivery of any debenture or certificate of debenture stock requiring registration with the registrar under the foregoing provisions of this Act without a copy of the certificate of registration being endorsed upon it, he shall, without prejudice to any other liability, be liable on summary conviction to a fine not exceeding one hundred pounds.

§ 31.—The Register of Mortgages.

100. —(1) Every limited company shall keep a register of mortgages and enter therein all mortgages and charges specifically affecting property of the company, giving in each case a short description of the property mortgaged or charged, the amount of the mortgage or charge, and (except in the case of securities to bearer) the names of the mortgagees or persons entitled thereto

(2) If any director, manager, or other officer of the company knowingly and wilfully authorises or permits the omission of any entry required to be made in pursuance of this section, he shall be liable to a fine not exceeding fifty pounds

The borrowing powers of a Company are usually defined in the Memorandum or Articles, and, unless such provision is made, a Company has no power to borrow unless such borrowing is properly incident to the carrying on of the business. A trading Company has an implied power to borrow and give security, even without any specific powers to do so. (*General Auction Estate Co. v. Smith*, 1891, 3 Ch. 432.)

The borrowing powers of a Company are commonly limited by the Articles, and any loan incurred beyond the limit, and the securities given for it, are void (*Howard v. Patent Ivory Co.*, 1888, 38 Ch. D. 156); if the loan is *ultra vires* the Directors, but *intra vires* the Company, it can be subsequently ratified by the Company (*Irvine v. Union Bank of Australia*, 1877, A.C. 366). An overdraft at a Bank must be taken into account where limited powers of borrowing are involved. (*Looker v. Writtle*, 1880. 9 Q.B.D. 397.)

Debentures may either be secured by a fixed charge on specific assets, or by a floating charge on the general undertaking of the Company, which may or may not include a charge on the uncalled Capital.

Uncalled Capital created under § 59, which cannot be called up except in the event of Liquidation, cannot be made the subject of a charge. (*Bartlett v. Mayfair Property Co.*, 1898, 2 Ch. 28.)

The practice, at one time common in certain classes of Companies, of creating a floating charge after it is known that the Company is insolvent, and immediately prior to the Company going into Liquidation, for the purpose of securing an already existing debt, is defeated by § 212, under which every floating charge, if created within three months of the commencement of winding-up, is invalid except as to the amount of any cash paid to the Company at the time of, or subsequent to, the creation of, and in consideration for, the charge, together with interest on that amount at the rate of 5 per cent. per annum.

§ 32. —Register of Debenture-holders.

102.—(1) Every register of holders of debentures of a company shall, except when closed in accordance with the articles during such period or periods (not exceeding in the whole thirty days in any year) as may be specified in the articles, be open to the inspection of the registered holder of any such debentures, and of any holder of shares in the company, but subject to such reasonable restrictions as the company may in general meeting impose, so that at least two hours in each day are appointed for inspection, and every such holder may require a copy of the register or any part thereof on payment of sixpence for every one hundred words required to be copied.

(2) A copy of any trust deed for securing any issue of debentures shall be forwarded to every holder of any such debentures at his request on payment in the case of a printed trust deed of the sum of one shilling or such less sum as may be prescribed by the company, or, where the trust deed has not been printed, on payment of sixpence for every one hundred words required to be copied.

(3) If inspection is refused, or a copy is refused or not forwarded, the company shall be liable to a fine not exceeding five pounds, and to a further fine not exceeding two pounds for every day during which the refusal continues, and every director, manager, secretary, or other officer of the company who knowingly authorises or permits the refusal shall incur the like penalty.

Although the above section refers to the Register of Debenture-holders, there is no provision requiring the Company to keep such a book.

§ 33.—Irredeemable Debentures.

103. A condition contained in any debentures or in any deed for securing any debentures, whether issued or executed before or after the passing of this Act, shall not be invalid by reason only that thereby the debentures are made irredeemable or redeemable only on the happening of a contingency, however remote, or on the expiration of a period, however long, any rule of equity to the contrary notwithstanding.

Although it had been customary for some years to issue Debentures or Debenture Stock described as "Perpetual" or "Irredeemable," doubts were expressed whether such provisions did not in fact amount to a clog on the equity of Redemption, thus rendering it invalid.

The above section defines the law as being in accordance with practice.

§ 34.—Re-issue of Redeemed Debentures.

104.—(1) Where either before or after the passing of this Act a company has redeemed any debentures previously issued, the company, unless the articles or the conditions of issue expressly otherwise provide, or unless the debentures have been redeemed in pursuance of any obligation on the company so to do (not being an obligation enforceable only by the person to whom the redeemed debentures were issued or his assigns), shall have power, and shall be deemed always to have had power, to keep the debentures alive for the purposes of re-issue, and where a company has purported to exercise such a power the company shall have power, and shall be deemed always to have had power, to re-issue the debentures either by re-issuing the same debentures or by issuing other debentures in their place, and upon such a re-issue

the person entitled to the debentures shall have, and shall be deemed always to have had, the same rights and priorities as if the debentures had not previously been issued.

(2) Where with the object of keeping debentures alive for the purpose of re issue they have either before or after the passing of this Act been transferred to a nominee of the company, a transfer from that nominee shall be deemed to be a re issue for the purposes of this section

(3) Where a company has either before or after the passing of this Act deposited any of its debentures to secure advances from time to time on current account or otherwise, the debentures shall not be deemed to have been redeemed by reason only of the account of the Company having ceased to be in debit whilst the debentures remained so deposited

(4) The re issue of a debenture or the issue of another debenture in its place under the power by this section given to, or deemed to have been possessed by, a company whether the re issue or issue was made before or after the passing of this Act shall be treated as the issue of a new debenture for the purposes of stamp duty, but it shall not be so treated for the purposes of any provision limiting the amount or number of debentures to be issued.

The above section was introduced into the Companies Act, 1907, as a result of various decisions which had been made by the Courts reversing what was thought to be the legal position with regard to the re-issue of redeemed Debentures. It had been held that a Company could not re-issue any Debentures which had been redeemed, to rank *pari passu* with other Debentures of the same series, unless power to do so was a condition of the original issue (*George Routledge & Sons*, 1904, 2 Ch. 474; *W. Tasker & Sons*, 1905, 2 Ch. 587). The result of these decisions was that a Company, not having taken power to re-issue at the time the original issue of Debentures was made, found that when some of the Debentures had been redeemed, the whole of the security afforded by the assets charged under the original issue was appropriated to the remaining Debenture-holders of the series, greatly enhancing their security, but at the same time reducing the resources of the Company for

borrowing purposes. This interpretation of the law created considerable difficulties, since a large number of Companies had been in the habit of re-issuing their redeemed Debentures, and serious doubts arose as to their validity. For this reason the provisions in this section, empowering a Company to re-issue redeemed Debentures in certain cases, was made retrospective, except in so far as the particular cases which had already been the subject of the decisions of the Court.

Sub-section (3) expressly provides for cases where Debentures are deposited as collateral security for an Overdraft, when such Debentures shall not be deemed to have been redeemed merely by reason of the Overdraft having been paid off. It had been held that when an Overdraft was paid off the Debentures were redeemed, and the security afforded by them gone (*London General Investment Trust v. Russian Petroleum Co.*, 1907, 2 Ch. 540); but this is now no longer the case.

§ 35.—Statement to be published by Banking and certain other Companies.

108.—(1) Every company being a limited banking company or an insurance company or a deposit, provident, or benefit society shall, before it commences business, and also on the first Monday in February and the first Tuesday in August in every year during which it carries on business, make a statement in the form marked C in the First Schedule to this Act, or as near thereto as circumstances will admit.

(2) A copy of the statement shall be put up in a conspicuous place in the registered office of the company, and in every branch office or place where the business of the company is carried on

(3) Every member and every creditor of the company shall be entitled to a copy of the statement, on payment of a sum not exceeding sixpence

(4) If default is made in compliance with this section, the company shall be liable to a fine not exceeding five pounds for every day during

which the default continues; and every director and manager of the company who knowingly and wilfully authorises or permits the default shall be liable to the like penalty.

(5) For the purposes of this Act a company that carries on the business of insurance in common with any other business or businesses shall be deemed to be an insurance company.

(6) This section shall not apply to any life assurance company nor any other assurance company to which the provisions of the Life Assurance Companies Acts, 1870 to 1872, as to the annual statements to be made by such a company, apply with or without modifications, if the company complies with those provisions.

The following is the Form prescribed:—

FORM C.

FORM OF STATEMENT to be published by BANKING and INSURANCE COMPANIES, and DEPOSIT, PROVIDENT, or BENEFIT SOCIETIES.

* The share capital of the company is _____, divided into
shares of _____ each.

The number of shares issued is _____

Calls to the amount of _____ pounds per share have been
made, under which the sum of _____ pound has been received.

The liabilities of the company on the first day of January (or July)
were—

Debts owing to sundry persons by the company.

On judgment, £

On specialty, £

On notes or bills, £

On simple contracts, £

On estimated liabilities, £

The assets of the company on that day were—

Government securities [*stating them*]

Bills of exchange and promissory notes, £

Cash at the bankers, £

Other securities, £

§ 36.—Investigation by Board of Trade Inspectors.

109.—(1) The Board of Trade may appoint one or more competent inspectors to investigate the affairs of any company and to report thereon in such manner as the Board direct—

- (i) In the case of a banking company having a share capital, on the application of members holding not less than one third of the shares issued:

* If the company has no share capital the portion of the statement relating to capital and shares must be omitted.

(u) In the case of any other company having a share capital, on the application of members holding not less than one tenth of the shares issued :

(uu) In the case of a company not having a share capital, on the application of not less than one fifth in number of the persons on the company's register of members

(2) The application shall be supported by such evidence as the Board of Trade may require for the purpose of showing that the applicants have good reason for, and are not actuated by malicious motives in requiring, the investigation, and the Board of Trade may, before appointing an inspector, require the applicants to give security for payment of the costs of the inquiry

(3) It shall be the duty of all officers and agents of the company to produce to the inspectors all books and documents in their custody or power

(4) An inspector may examine on oath the officers and agents of the company in relation to its business, and may administer an oath accordingly

(5) If any officer or agent refuses to produce any book or document which under this section it is his duty to produce, or to answer any question relating to the affairs of the company, he shall be liable to a fine not exceeding five pounds in respect of each offence

(6) On the conclusion of the investigation the inspectors shall report their opinion to the Board of Trade, and a copy of the report shall be forwarded by the Board to the registered office of the company, and a further copy shall, at the request of the applicants for the investigation, be delivered to them

The report shall be written or printed, as the Board direct

(7) All expenses of and incidental to the investigation shall be defrayed by the applicants, unless the Board of Trade direct the same to be paid by the company, which the Board is hereby authorised to do.

This power of Inspection by the Board of Trade is very rarely used, but a recent case has arisen in which the Directors requested the late Auditors of the Company to attend and give evidence, and produce accounts and documents in their custody, under sub-sections (3) and (4); but the Auditors declined to do this, on the ground that they were no longer Officers or Agents of the Company, having retired from the position of Auditors previous to the commencement of the Inspection. The point raised by the Auditors has

not been taken into the Courts, and therefore it cannot be said whether or not it would be upheld; but it would appear that they were technically within their rights.

It is clear that if any Officer or Agent of the Company, by the mere fact of his retirement prior to the commencement of the Inspection, can refuse to attend the enquiries, or produce any books and documents in his possession, one of the principal advantages of the section disappears; and it would seem that the powers afforded to the Inspectors should be extended to refer to all those persons who either are, or have been, Officers or Agents of the Company. Although the point has not been tested, it would appear that the Auditor would be an Officer under this section, in the same manner as he has been held to be an Officer under § 215.

§ 37. —Investigation by Inspectors appointed by the Company.

110. -(1) A company may by special resolution appoint inspectors to investigate its affairs.

(2) Inspectors so appointed shall have the same powers and duties as inspectors appointed by the Board of Trade, except that, instead of reporting to the Board, they shall report in such manner and to such persons as the company in general meeting may direct.

(3) Officers and agents of the company shall incur the like penalties in case of refusal to produce any book or document required to be produced to inspectors so appointed, or to answer any question, as they would have incurred if the inspectors had been appointed by the Board of Trade.

111. A copy of the report of any inspectors appointed under this Act, authenticated by the seal of the company whose affairs they have investigated, shall be admissible in any legal proceeding as evidence of the opinion of the inspectors in relation to any matter contained in the report.

§ 38.—Auditors

112.—(1) Every company shall at each annual general meeting appoint an auditor or auditors to hold office until the next annual general meeting.

(2) If an appointment of auditors is not made at an annual general meeting, the Board of Trade may, on the application of any member of the company, appoint an auditor of the company for the current year, and fix the remuneration to be paid to him by the company for his services.

(3) A director or officer of the company shall not be capable of being appointed auditor of the company.

(4) A person, other than a retiring auditor, shall not be capable of being appointed auditor at an annual general meeting, unless notice of an intention to nominate that person to the office of auditor has been given by a shareholder to the company, not less than fourteen days before the annual general meeting, and the company shall send a copy of any such notice to the retiring auditor, and shall give notice thereof to the shareholders, either by advertisement or in any other mode allowed by the articles, not less than seven days before the annual general meeting.

Provided that if, after notice of the intention to nominate an auditor has been so given, an annual general meeting is called for a date fourteen days or less after the notice has been given, the notice, though not given within the time required by this provision, shall be deemed to have been properly given for the purposes thereof, and the notice to be sent or given by the company may, instead of being sent or given within the time required by this provision, be sent or given at the same time as the notice of the annual general meeting.

(5) The first auditors of the company may be appointed by the directors before the statutory meeting, and if so appointed shall hold office until the first annual general meeting, unless previously removed by a resolution of the shareholders in general meeting, in which case the shareholders at that meeting may appoint auditors.

(6) The directors may fill any casual vacancy in the office of auditor, but while any such vacancy continues the surviving or continuing auditor or auditors (if any) may act.

(7) The remuneration of the auditors of a company shall be fixed by the company in general meeting, except that the remuneration of any auditors appointed before the statutory meeting, or to fill any casual vacancy, may be fixed by the directors.

113.—(1) Every auditor of a company shall have a right of access at all times to the books and accounts and vouchers of the company, and shall be entitled to require from the directors and officers of the company such information and explanation as may be necessary for the performance of the duties of the auditors.

(2) The auditors shall make a report to the shareholders on the accounts examined by them, and on every balance sheet laid before

the company in general meeting during their tenure of office, and the report shall state—

- (a) whether or not they have obtained all the information and explanations they have required; and
- (b) whether, in their opinion, the balance sheet referred to in the report is properly drawn up so as to exhibit a true and correct view of the state of the company's affairs according to the best of their information and the explanations given to them, and as shown by the books of the company.

(3) The balance sheet shall be signed on behalf of the board by two of the directors of the company, or if there is only one director by that director, and the auditors' report shall be attached to the balance sheet, or there shall be inserted at the foot of the balance sheet a reference to the report, and the report shall be read before the company in general meeting, and shall be open to inspection by any shareholder.

Any shareholder shall be entitled to be furnished with a copy of the balance sheet and auditors' report at a charge not exceeding sixpence for every hundred words.

(4) If any copy of a balance sheet which has not been signed as required by this section is issued, circulated, or published, or if any copy of a balance sheet is issued, circulated, or published without either having a copy of the auditors' report attached thereto or containing such reference to that report as is required by this section, the company, and every director, manager, secretary, or other officer of the company who is knowingly a party to the default, shall on conviction be liable to a fine not exceeding fifty pounds.

(5) In the case of a banking company registered after the fifteenth day of August, eighteen hundred and seventy nine—

- (a) if the company has branch banks beyond the limits of Europe it shall be sufficient if the auditor is allowed access to such copies of and extracts from the books and accounts of any such branch as have been transmitted to the head office of the company in the United Kingdom; and
- (b) the balance sheet must be signed by the secretary or manager (if any), and where there are more than three directors of the company by at least three of those directors, and where there are not more than three directors by all the directors.

114.—(1) Holders of preference shares and debentures of a company shall have the same right to receive and inspect the balance sheets of the company and the reports of the auditors and other reports as is possessed by the holders of ordinary shares in the company.

(2) This section shall not apply to a private company, nor to a company registered before the first day of July nineteen hundred and eight.

The above sections have been fully dealt with in
Chapter VI.

§ 39.—Liability of Directors and Officers for Misfeasance or Breach of Trust.

215.—(1) Where in the course of winding up a company it appears that any person who has taken part in the formation or promotion of the company, or any past or present director, manager, or liquidator, or any officer of the company, has misapplied or retained or become liable or accountable for any money or property of the company, or been guilty of any misfeasance or breach of trust in relation to the company, the court may, on the application of the official receiver or of the liquidator, or of any creditor or contributory, examine into the conduct of the promoter, director, manager, liquidator, or officer, and compel him to repay or restore the money or property or any part thereof respectively with interest at such rate as the court thinks just, or to contribute such sum to the assets of the company by way of compensation in respect of the misapplication, retention, misfeasance, or breach of trust as the court thinks just.

(2) This section shall apply notwithstanding that the offence is one for which the offender may be criminally responsible.

An Auditor has been held to be an Officer under this section (*London & General Bank*, No. 1, 1895, 2 Ch. 166; *Kingston Cotton Mill Co., Ltd.*, 1896, 1 Ch. 6); these cases have been considered in Chapter VI., § 2, where the question as to whether an Auditor can be said to be in all cases an Officer of the Company is discussed. The nature and extent of the Auditor's liability is fully dealt with in Chapter XII. on the Liabilities of Auditors.

The Secretary is an Officer of the Company (*McKay's case*, 1876, 2 Ch. D. 1). The Company's Bankers are not Officers within the section (*Imperial Land Co. of Marseilles*, 1870, 10 Eq. 208); nor in the ordinary course is a Company's Solicitor (*Carter's case*, 1886, 31 Ch. D. 496); but a Solicitor has been held to be an Officer when he does all the work for a fixed salary (*Liberator Building Society*, 1894, 71 L.T. 406).

The term "breach of trust" is applied to cases involving misapplication of the funds of the Company; the term "misfeasance" to cases involving other breaches of duty. Misfeasance must result in damage.

to the Company (*Coventry & Dixon's case*, 1880, 14 Ch. D. 660). It is not within the province of this work to discuss in detail the various cases of misfeasance affecting Directors; but it may be desirable to note a few of the more important. Directors may be liable under this section to make good with interest the amount of dividends improperly declared (*Stringer's case*, 1869, 4 Ch. D. 475; *National Funds Assurance Co.*, 1879, 10 Ch. D. 118; *Oxford Benefit Building Society*, 1887, 35 Ch. D. 502; *London & General Bank* (2), 1895, 2 Ch. 673); or dividends paid where there are no profits available (*re Sharpe v. Bennett*, 1892, 1 Ch. 154; *National Bank of Wales*, 1899, 2 Ch. 650); but if the Shareholders received their dividends knowing that they were paid out of Capital, the Directors will have a right to recover from such Shareholders to the extent to which they have received such dividends (*Moxham v. Grant*, 1900, 1 Q.B. 88).

Directors may be liable for improperly obtaining qualification shares from promoters or vendors (*De Ruvigne's case*, 1877, 5 Ch. D. 306; *Pearson's case*, 1877, 5 Ch. D. 336); or for receiving gifts of shares from the Vendor (*Postage Stamp, &c., Co.*, 1892, 3 Ch. 566); or for making gifts to themselves without the sanction of the Articles (*Geo. Newman & Co.*, 1895, 1 Ch. 674); or for making illegitimate profits by dealing in the Company's shares (*Parker v. McKenna*, 1875, 10 Ch. 118); or for secret commission (*Boston Deep Sea Co. v. Ansell*, 1888, 39 Ch. D. 339); or for not disclosing their interests in Contracts with the Company (*in re Cape Breton Co.*, 12 A.C. 652).

§ 279 provides relief in certain cases as follows:—

279. If in any proceeding against a director, or person occupying the position of director, of a company for negligence or breach of

trust it appears to the court hearing the case that the director or person is or may be liable in respect of the negligence or breach of trust, but has acted honestly and reasonably, and ought fairly to be excused for the negligence or breach of trust, that court may relieve him, either wholly or partly, from his liability on such terms as the court may think proper

Where the Articles of a Company provide that Directors shall not be liable for damages occasioned even by their negligence, where such negligence is not dishonest, no action under § 215 can lie. (*In re Brazilian Rubber Plantation and Estates, Ltd.*, 1911, L.J. Ch 221)

§ 40. – Penalties for False Statements.

281. If any person in any return, report, certificate, balance sheet, or other document required by or for the purposes of any of the provisions of this Act specified in the Fifth Schedule hereto, wilfully makes a statement false in any material particular, knowing it to be false, he shall be guilty of a misdemeanor, and shall be liable on conviction on indictment to imprisonment for a term not exceeding two years, with or without hard labour and on summary conviction to imprisonment for a term not exceeding four months, with or without hard labour, and in either case to a fine in lieu of or in addition to such imprisonment as aforesaid:

Provided that the fine imposed on summary conviction shall not exceed one hundred pounds

The words printed in italics were repealed and substantially re-enacted by the Perjury Act, 1911 (§ 5).

§ 41.—The Companies (Particulars as to Directors) Act, 1917.

The object of the Act is to prevent the purpose of the Registration of Business Names Act, 1916, from being defeated by converting the firm into a private company. § 1 applies to all companies and provides: (1) that the annual summary of a British company; (2) the return to the Registrar to be made by a Foreign Company carrying on business here; and (3) the Register of Directors must give the same particulars

with regard to Directors as would be necessary if they were partners in a firm requiring registration.

In the case of Companies registered here, or establishing a place of business here, after the 22nd November, 1916, similar particulars are to appear on all trade catalogues, trade cards, circulars and business letters. The term "Director" includes not only actual Directors, but any person who occupies a position of a Director and applies to any person in accordance with whose directions or instructions the Directors of a Company are accustomed to act. The additional particulars required are: any former names; nationality if not British; if nationality be not nationality of origin, then in addition the nationality of origin.

§ 42.—The Companies(Foreign Interests)Act,1917.

Under this Act, a Company whose Articles contain any provisions limiting the interests or authority of aliens (N.B.—Not only enemy aliens), or the control of the Company by aliens, cannot alter these provisions without leave of the Board of Trade: the decision of the Board of Trade to be final and conclusive.

In such cases a Resolution for Voluntary Winding-up is to be of no effect unless ratified in writing by the Board of Trade.

The Court in such cases has discretion to refuse to make a Winding-up Order.

The Board or the Court shall be guided by the consideration whether the Winding-up is *bonâ fide*, or only with a view to getting rid of the restrictions.

The Board of Trade, in giving consent, or the Court in making a Winding-up Order, may impose such terms or conditions as it thinks fit.

SYNOPSIS OF CHAPTER VIII.

**Table "A" of the Companies (Consolidation)
Act, 1908.****§ 1 —THE APPLICATION OF TABLE "A"****2.—TABLE "A"—**

- (a) Shares
- (b) Calls on Shares
- (c) Forfeiture of Shares
- (d) Alteration of Capital.
- (e) Directors.
- (f) Powers and Duties of Directors.
- (g) Disqualification of Directors
- (h) Dividends and Reserves
- (i) Accounts.
- (j) Audit.

CHAPTER VIII.

TABLE "A" OF THE
COMPANIES (CONSOLIDATION) ACT, 1908.

§ 1.—The Application of Table "A."

Table "A" is contained in the First Schedule to the Companies (Consolidation) Act, 1908, and is a model set of Articles which must be adopted by all Companies not possessing Articles of their own, under § 11 of that Act, and in the case of Companies possessing Articles of their own, Table "A" applies in so far as it is not expressly excluded or modified.

The original Table "A" constituted the First Schedule to the Companies Act, 1862. It contained, however, many provisions which were inconvenient and obsolete, and under the powers conferred by that Act on the Board of Trade, a revised Table was issued, which came into operation on the 1st October, 1906, and applied to all Companies registered after that date. Companies registered before that date working under the old Table could adopt the revised form by Special Resolution, but were not obliged to do so, and many Companies continue to work under the old provisions. The present Table "A" incorporated in the Consolidation Act is the same as the revised Table, with the exception of one or two slight alterations, and applies to all Companies registered after the 1st April,

1909, in so far as they do not expressly exclude its operation. Where the original Table continues to operate, it can be looked upon in the light of special Articles in the same sense as if the Company had Articles of its own.

§ 2. — Table “A.”

The following are the most important clauses of Table “A” with which the Auditor should be familiar :

(a) **Shares.**

3 Subject to the provisions, if any, in that behalf of the memorandum of association of the company, and without prejudice to any special rights previously conferred on the holders of existing shares in the company, any share in the company may be issued with such preferred, deferred, or other special rights, or such restrictions, whether in regard to dividend, voting, return of share capital, or otherwise, as the company may from time to time by special resolution determine.

4 If at any time the share capital is divided into different classes of shares, the rights attached to any class (unless otherwise provided by the terms of issue of the shares of that class) may be varied with the consent in writing of the holders of three-fourths of the issued shares of that class, or with the sanction of an extraordinary resolution passed at a separate general meeting of the holders of the shares of the class. To every such separate general meeting the provisions of these regulations relating to general meetings shall mutatis mutandis apply, but so that the necessary quorum shall be two persons at least holding or representing by proxy one third of the issued shares of the class.

8 No part of the funds of the company shall be employed in the purchase of, or in loans upon the security of, the company's shares.

(b) **Calls on Shares.**

12 The directors may from time to time make calls upon the members in respect of any moneys unpaid on their shares, provided that no call shall exceed one-fourth of the nominal amount of the share, or be payable at less than one month from the last call; and each member shall (subject to receiving at least fourteen days' notice specifying the time or times of payment) pay to the company at the time or times so specified the amount called on his shares.

14. If a sum called in respect of a share is not paid before or on the day appointed for payment thereof, the person from whom the

sum is due shall pay interest upon the sum at the rate of five pounds per cent. per annum from the day appointed for the payment thereof to the time of the actual payment, but the directors shall be at liberty to waive payment of that interest wholly or in part.

15. The provisions of these regulations as to payment of interest shall apply in the case of nonpayment of any sum which, by the terms of issue of a share, becomes payable at a fixed time, whether on account of the amount of the share, or by way of premium, as if the same had become payable by virtue of a call duly made and notified.

17. The directors may, if they think fit, receive from any member willing to advance the same all or any part of the moneys uncalled and unpaid upon any shares held by him; and upon all or any of the moneys so advanced may (until the same would, but for such advance, become presently payable) pay interest at such rate (not exceeding, without the sanction of the company in general meeting, six per cent.) as may be agreed upon between the member paying the sum in advance and the directors.

(c) Forfeiture of Shares.

24. If a member fails to pay any call or instalment of a call on the day appointed for payment thereof, the directors may, at any time thereafter during such time as any part of such call or instalment remains unpaid, serve a notice on him requiring payment of so much of the call or instalment as is unpaid, together with any interest which may have accrued.

25. The notice shall name a further day (not earlier than the expiration of fourteen days from the date of the notice) on or before which the payment required by the notice is to be made, and shall state that in the event of nonpayment at or before the time appointed the shares in respect of which the call was made will be liable to be forfeited.

26. If the requirements of any such notice as aforesaid are not complied with, any share in respect of which the notice has been given may at any time thereafter, before the payment required by the notice has been made, be forfeited by a resolution of the directors to that effect.

27. A forfeited share may be sold or otherwise disposed of on such terms and in such manner as the directors think fit, and at any time before a sale or disposition the forfeiture may be cancelled on such terms as the directors think fit.

28. A person whose shares have been forfeited shall cease to be a member in respect of the forfeited shares, but shall, notwithstanding, remain liable to pay to the company all moneys which, at the date of forfeiture, were presently payable by him to the company in respect of the shares, but his liability shall cease if and when the company receive payment in full of the nominal amount of the shares.

29. A statutory declaration in writing that the declarant is a director of the company, and that a share in the company has been

duly forfeited on a date stated in the declaration, shall be conclusive evidence of the facts therein stated as against all persons claiming to be entitled to the share, and that declaration, and the receipt of the company for the consideration, if any, given for the share on the sale or disposition thereof shall constitute a good title to the share, and the person to whom the share is sold or disposed of shall be registered as the holder of the share, and shall not be bound to see to the application of the purchase money, if any, nor shall his title to the share be affected by any irregularity or invalidity in the proceedings in reference to the forfeiture, sale, or disposal of the share.

30. The provisions of these regulations as to forfeiture shall apply in the case of nonpayment of any sum which, by the terms of issue of a share, becomes payable at a fixed time, whether on account of the amount of the share, or by way of premium, as if the same had been payable by virtue of a call duly made and notified.

Under the original Table "A" the Shareholder remains liable for Calls in arrear at the time of forfeiture, notwithstanding the forfeiture; but under the present Table the liability of the Shareholder ceases as soon as the Company shall have received payment in full to the extent of the nominal amount of the shares.

Under the original Table the Forfeited Shares may be disposed of as the Company in General Meeting thinks fit. Under the present Table the Directors have the power of disposal; and further power is given for forfeiture of shares in respect of non-payment of premium.

(d) Alteration of Capital.

41. The directors may, with the sanction of an extraordinary resolution of the company, increase the share capital by such sum, to be divided into shares of such amount, as the resolution shall prescribe.

42. Subject to any direction to the contrary that may be given by the resolution sanctioning the increase of share capital, all new shares shall, before issue, be offered to such persons as at the date of the offer are entitled to receive notices from the company of general meetings in proportion as nearly as the circumstances admit, to the amount of the existing shares to which they are entitled. The offer shall be made by notice specifying the number of shares offered, and limiting a time within which the offer, if not accepted, will be deemed to be declined, and, after the expiration of that time, or on the receipt of an intimation from the person to whom the offer is made that he declines to accept

the shares offered, the directors may dispose of the same in such manner as they think most beneficial to the company. The directors may likewise so dispose of any new shares which (by reason of the ratio which the new shares bear to shares held by persons entitled to an offer of new shares) cannot, in the opinion of the directors, be conveniently offered under this article.

43. The new shares shall be subject to the same provisions with reference to the payment of calls, lien, transfer, transmission, forfeiture, and otherwise as the shares in the original share capital.

44. The company may, by special resolution —

- (a) Consolidate and divide its share capital into shares of larger amount than its existing shares :
- (b) By subdivision of its existing shares, or any of them, divide the whole or any part of its share capital into shares of smaller amount than is fixed by the memorandum of association, subject, nevertheless, to the provisions of paragraph (d) of subsection (1) of section forty-one of the Companies (Consolidation) Act, 1908 :
- (c) Cancel any shares which, at the date of the passing of the resolution, have not been taken or agreed to be taken by any person :
- (d) Reduce its share capital in any manner and with and subject to any incident authorised and consent required by law.

Under the original Table "A" the Company can increase its Capital by Special Resolution ; under the present Table increase can be effected by Extraordinary Resolution. No power is given in the original Table for the reduction or alteration of Capital except by forfeiture of shares.

(e) Directors.

68. The number of the directors and the names of the first directors shall be determined in writing by a majority of the subscribers of the memorandum of association.

69. The remuneration of the directors shall from time to time be determined by the company in general meeting.

70. The qualification of a director shall be the holding of at least one share in the company, and it shall be his duty to comply with the provisions of section seventy-three of the Companies (Consolidation) Act, 1908.

Under the original Table "A" no share qualification is required for Directors.

(f) Powers and Duties of Directors.

71. The business of the company shall be managed by the directors, who may pay all expenses incurred in getting up and registering the company, and may exercise all such powers of the company as are not, by the Companies (Consolidation) Act, 1908, or any statutory modification thereof for the time being in force, or by these articles, required to be exercised by the company in general meeting, subject nevertheless to any regulations of these articles, to the provisions of the said Act, and to such regulations being not inconsistent with the aforesaid regulations or provisions, as may be prescribed by the company in general meeting; but no regulation made by the company in general meeting shall invalidate any prior act of the directors which would have been valid if that regulation had not been made.

72. The directors may from time to time appoint one or more of their body to the office of managing director or manager for such term and at such remuneration (whether by way of salary, or commission, or participation in profits, or partly in one way and partly in another) as they may think fit, and a director so appointed shall not, while holding that office, be subject to retirement by rotation, or taken into account in determining the rotation of retirement of directors; but his appointment shall be subject to determination ipso facto if he ceases from any cause to be a director, or if the company in general meeting resolve that his tenure of the office of managing director or manager be determined.

73. The amount for the time being remaining undischarged of moneys borrowed or raised by the directors for the purposes of the company (otherwise than by the issue of share capital) shall not at any time exceed the issued share capital of the company without the sanction of the company in general meeting.

74. The directors shall duly comply with the provisions of the Companies (Consolidation) Act, 1908, or any statutory modification thereof for the time being in force, and in particular with the provisions in regard to the registration of the particulars of mortgages and charges affecting the property of the company, or created by it, and to keeping a register of the directors, and to sending to the Registrar of Companies an annual list of members, and a summary of particulars relating thereto, and notice of any consolidation or increase of share capital, or conversion of shares into stock, and copies of special resolutions, and a copy of the register of directors and notifications of any changes therein.

75. The directors shall cause minutes to be made in books provided for the purpose –

- (a) of all appointments of officers made by the directors;
- (b) of the names of the directors present at each meeting of the directors and of any committee of the directors;
- (c) of all resolutions and proceedings at all meetings of the company, and of the directors, and of committees of directors;

and every director present at any meeting of directors or committee of directors shall sign his name in a book to be kept for that purpose.

Under the original Table "A" the Directors have no power to appoint a Managing Director.

(g) Disqualifications of Directors.

77. The office of director shall be vacated if the director—

- (a) ceases to be a director by virtue of section seventy-three of the Companies (Consolidation) Act, 1908; or
- (b) holds any other office of profit under the company except that of managing director or manager; or
- (c) becomes bankrupt; or
- (d) is found lunatic or becomes of unsound mind; or
- (e) is concerned or participates in the profits of any contract with the company:

Provided, however, that no director shall vacate his office by reason of his being a member of any company which has entered into contracts with or done any work for the company of which he is director; but a director shall not vote in respect of any such contract or work, and if he does so vote his vote shall not be counted.

(h) Dividends and Reserve.

95. The company in general meeting may declare dividends, but no dividend shall exceed the amount recommended by the directors.

96. The directors may from time to time pay to the members such interim dividends as appear to the directors to be justified by the profits of the company.

97. No dividend shall be paid otherwise than out of profits.

98. Subject to the rights of persons, if any, entitled to shares with special rights as to dividends, all dividends shall be declared and paid according to the amounts paid on the shares, but if and so long as nothing is paid up on any of the shares in the company dividends may be declared and paid according to the amounts of the shares. No amount paid on a share in advance of calls shall, while carrying interest, be treated for the purposes of this article as paid on the share.

99. The directors may, before recommending any dividend, set aside out of the profits of the company such sums as they think proper as a reserve or reserves which shall, at the discretion of the directors, be applicable for meeting contingencies, or for equalising dividends, or for any other purpose to which the profits of the company may be properly applied, and pending such application may, at the like discretion, either be employed in the business of the company or be invested in such investments (other than shares of the company) as the directors may from time to time think fit.

100. If several persons are registered as joint holders of any share any one of them may give effectual receipts for any dividend payable on the share.

101. Notice of any dividend that may have been declared shall be given in manuer hereinafter mentioned to the persons entitled to share therein.

102. No dividend shall bear interest against the company.

Under the original Table "A" there is no provision to pay interim dividends, and dividends could only be paid *out of profits from carrying on the business of the Company*. Under the present Table interim dividends can be paid if the profits of the Company justify such a course; and the restriction of the definition of profits as arising from carrying on the business of the Company is deleted. What constitutes profits available for dividend, and the meaning of the term profits generally, is a most important subject, which will be discussed in Chapter X.

Under the original Table, dividends must be paid according to the nominal value of the shares, irrespective of the amounts paid up. In some cases this operates very inequitably as between Shareholders, and the present Table provides that dividends shall be paid according to the amounts paid up on the shares, exclusive of calls paid in advance bearing interest.

Under the original Table power is given to forfeit the dividends unclaimed after a period of three years from the date of declaration. No such power is given in the present Table. Under the regulations of the Stock Exchange no quotation will be granted to a Company which takes powers to forfeit unclaimed dividends.

(4) Accounts.

103. The directors shall cause true accounts to be kept—

- (a) of the sums of money received and expended by the company and the matter in respect of which such receipt and expenditure takes place; and

• (b) of the assets and liabilities of the company.

104. The books of account shall be kept at the registered office of the company, or at such other place or places as the directors think fit, and shall always be open to the inspection of the directors.

105. The directors shall from time to time determine whether and to what extent and at what times and places and under what conditions or regulations the accounts and books of the company or any of them shall be open to the inspection of members not being directors, and no member (not being a director) shall have any right of inspecting any account or book or document of the company except as conferred by statute or authorised by the directors or by the company in general meeting.

106. Once at least in every year the directors shall lay before the company in general meeting a profit and loss account for the period since the preceding account or (in the case of the first account) since the incorporation of the company, made up to a date not more than six months before such meeting.

107. A balance sheet shall be made out in every year and laid before the company in general meeting, made up to a date not more than six months before such meeting. The balance sheet shall be accompanied by a report of the directors as to the state of the company's affairs, and the amount which they recommend to be paid by way of dividend, and the amount, if any, which they propose to carry to a reserve fund.

108. A copy of the balance sheet and report shall, seven days previously to the meeting, be sent to the persons entitled to receive notices of general meetings in the manner in which notices are to be given hereunder.

Under the original Table true accounts must be kept of Stock-in-trade, Receipts and Payments, and Credits and Liabilities. The present Table revises the clause in such a way as to practically require the Company to keep proper books by Double Entry.

Under the original Table the books of account are open to the inspection of all members of the Company. This power is frequently abused, persons becoming members solely for the purpose of enabling them to inspect the books of the Company, and obtain information which they might use to the disadvantage of the Company. Consequently, the present Table provides that no Shareholder not being a Director shall have access to the books, other than as conferred by

Statute, or authorized by the Directors, or by the Company in General Meeting.

The provisions in the original Table relating to the form of Accounts have become obsolete, and are materially revised in the present Table. In the place of the Income and Expenditure Account it is now necessary to submit a Profit and Loss Account to the Shareholders. The Profit and Loss Account and Balance Sheet must be made up to a date not more than six months before the Meeting. In the original Table the period is three months, but this has been found to be too short in many cases, particularly where accounts have to be received from abroad.

Under the original Table, a form of Balance Sheet was prescribed, and Companies working thereunder must still adhere to such form, as far as circumstances permit. In practice, however, it has been found inconvenient to lay down any prescribed form of Balance Sheet, and no specific form is required by the present Table "A."

(j) Audit.

109. Auditors shall be appointed and their duties regulated in accordance with sections one hundred and twelve and one hundred and thirteen of the Companies (Consolidation) Act, 1908, or any statutory modification thereof for the time being in force

The clauses in the original Table "A" relating to Audit, apply in the case of those Companies continuing to work under that Table, except in so far as they are superseded by §§ 112 and 113 of the Companies (Consolidation) Act, 1908. The only point of importance in this connection is that under the original Table the Auditor is required to report that the Balance Sheet is "full and fair," whereas these words are not required under the present Table.

SYNOPSIS OF CHAPTER IX.

The Audit of a Limited Company.

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- (a) Purchase of Business
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- (a) Liability of Directors to Account
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10 — MINUTE BOOKS

- (a) Directors' Minute Book
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11 — RESERVE FUNDS.

12.—SECRET OR INTERNAL RESERVE.

13.—INCOME TAX.

CHAPTER IX.

THE AUDIT OF A LIMITED COMPANY.

§ 1. - **Considerations on appointment as Auditor.**

The general considerations on the commencement of a new Audit have been dealt with in Chapter I., § 5 (b), and the importance of obtaining a list of the books in use and a statement of the Internal Check in operation (if any) has been pointed out. In the case of a Limited Company, there are further points which the Auditor should consider at this stage :

(a) **The Appointment of the Auditor.**

If the Company is a new one, the Directors have power under § 112 of the Companies (Consolidation) Act, 1908, to appoint the Auditor prior to the first Statutory Meeting; and if the Auditor is so appointed, he should obtain from the Secretary of the Company a copy of the Directors' Minute recording his appointment. If appointed by the Shareholders in General Meeting, in succession to the previous Auditor, he should obtain a copy of the Resolution, and ascertain that due notice of his nomination was given to the Shareholders and the retiring Auditor in accordance with the provisions of § 112 (4), since if this has not been done his appointment will be invalid.

In the case of a casual vacancy in the office of Auditor, occasioned either by the death or retirement

of the Auditor during his year of office, the Directors have power to appoint a new Auditor, and the Auditor so appointed should obtain a copy of the Directors' Minute appointing him.

Before allowing himself to be nominated as Auditor in a case where the retiring Auditor is seeking re-election, an Accountant should make careful enquiries in order to avoid any breach of professional etiquette.

(b) Remuneration of the Auditor.

Where the Auditor is appointed by the Directors, the remuneration can be fixed by them in the first instance. Subsequently, the remuneration will be fixed by the Shareholders in General Meeting.

The amount of the fee is generally based on the time which the Audit is estimated to occupy, regard being had to the responsibility involved. The Auditor is usually asked to quote a fee for which he would be willing to perform the Audit, but it is sometimes very difficult to do this with any degree of accuracy, and an arrangement is frequently made whereby the remuneration is agreed upon with the Directors after the Audit is completed. In succeeding years, however, the remuneration is commonly voted in advance by the Shareholders at the time of the reappointment of the Auditor, and the amount of the fee is usually agreed upon between the Auditor and the Directors, before the matter comes before the Shareholders. Sometimes the Auditor's remuneration is voted retrospectively.

In cases where the books of the Company are not balanced prior to the Audit, or where draft accounts are not prepared by the Company's officials and

presented to the Auditor, he should make it clear to the Directors that it is no part of his duty to perform work of this nature, and if it is desired that he should do this it will be in his capacity as Accountant. A separate fee should be arranged for additional work of this kind, or, alternatively, the Audit fee may be increased to include it.

(c) Inspection of Books and Documents.

In addition to obtaining a list of all the books in use and inspecting these, the Auditor should examine the following documents :

(1) *The Memorandum and Articles of Association.*

Particular reference should be made to the following points : --

- (a) The Objects of the Company.
- (b) The Share Capital, the number of shares into which it is divided, and the rights of Shareholders *inter se*.
- (c) How far the provisions of Table "A" apply, or whether they are expressly excluded. In so far as the Articles do not exclude or modify the Regulations in Table "A," the same apply.
- (d) The Regulations as to the issue of Capital, Minimum Subscription, payment of Underwriting Commission, &c.
- (e) The Number, Remuneration, and Qualification of Directors.
- (f) Proceedings and Powers of the Board.
- (g) Accounts and Audit.
- (h) Dividends and Reserves.

(2) *The Prospectus.*

Where a Prospectus has been issued, the Auditor should examine this, with particular reference to the following points :

- (a) The amount of Capital proposed to be issued, the different classes of shares to which it relates, and the rights of Shareholders *inter se*.
- (b) The Qualification and Remuneration of Directors.
- (c) The minimum Subscription, and the amounts payable on application and allotment ; also the dates fixed for future calls, and the amounts thereof, if any.
- (d) Particulars of any Contract entered into with the Vendors for the purchase of any property, and the amount payable in cash, shares or debentures in respect of such purchase consideration. The amount, if any, payable for goodwill must be specified separately.
- (e) The amount payable for Underwriting Commission, or for Commission on placing Shares or Debentures.
- (f) The amount, or estimated amount, of Preliminary Expenses.
- (g) Particulars of any material Contracts entered into.

(3) *Contracts.*

The Auditor should examine all Contracts with vendors or other persons relating to the purchase of property, payment of commission, or preliminary expenses.

(4) *Balance Sheet, Accounts and Reports.*

Except in the case of a new Company, the Auditor should examine the last Balance Sheet and Accounts,

as these will form the basis for the period under review.

The late Auditor's Report should be examined, as this may contain material information which it is important the new Auditor should be aware of.

The last Report of the Directors to the Shareholders should be seen, as this will contain the recommendations of the Directors in respect of the appropriation of the previous year's profits. The Shareholders' Minute Book should be examined, in order to ascertain whether such recommendations have been carried out.

§ 2.—Share Capital.

(a) The Various Classes of Share Capital.

The Share Capital of a Company is frequently divided into different classes, of which the following are the most usual:—

(1) *Preference Shares.*

Preference Shares may be either *Simple* or *Cumulative*. The former only carry right to a fixed dividend out of the profits of any year, and if there are insufficient profits in that year to pay the full amount of dividend, they have no right to have such arrears made up out of future profits. They may or may not have a right in respect to repayment of Capital in priority to other classes of shares in the event of liquidation.

Cumulative Preference Shares entitle the holders to a fixed rate of dividend in the same way as Simple Preference Shares, but with the additional right that any arrears of dividend shall be made up out of future profits, in priority to any dividends on other classes of shares.

The rights of Preference Shareholders are governed by the Memorandum and Articles of Association, and there are other varieties than the two enumerated above; such as, for example, those giving a right to participate in further dividends after the Ordinary Shares have received a certain rate per cent. The question as to how far the rights of Preference Shareholders may be varied, has been dealt with in Chapter VII., § 10.

Where it is stated that Preference Shares are entitled to a preferential dividend at a specified rate per cent., such dividend is *prima facie* Cumulative. (*Webb v. Earle*, 1875, 20 Eq. 556; *Henry v. Gl. N. Rly. Co.*, 1 de G. & J. 606; *Foster v. Coles and M. B. Foster & Sons*, 1906, W.N. 107.) If the intention is that the Preference Shares should be Simple, the clause defining their rights must clearly express this. A declaration that the Preference dividend is to be paid out of the profits "of each year," has been interpreted as not giving cumulative rights (*Staples v. Eastman Co.* 1896, 2 Ch. 303).

In the absence of specific provision Preference Shares entitled to a fixed cumulative dividend are not entitled to share in any surplus profits after such dividend has been paid (*Will v. United Lankat Plantations Co.* 1913, 30 T.L.R. 37).

A Preference Shareholder is not entitled to preference in respect of return of Capital, unless specific rights are attached in this connection (*London India Rubber Co.* 1866, 5 Eq. 519); but if such rights are given, the right to a further share in the surplus assets is in effect negatived in the absence of special provisions in the Articles (re *National Telephone Co., Ltd.*, 1913, L.T. 321).

The rights of Preference Shareholders to the payment of arrears accumulated on Preference Dividends, in the event of Liquidation, are discussed in Chapter X., § 4 (*d*).

(2) *Ordinary Shares.*

Ordinary Shares are those taking the surplus profits remaining after satisfaction of prior interests (if any).

These may be divided as between Preferred and Deferred Ordinary Shares, the former having a preferential right to a fixed rate of dividend over the latter, while the latter frequently have a right to the whole, or a proportion of the surplus profits after the provision of dividends on other classes of shares.

(3) *Founders' or Deferred Shares.*

Founders' or Deferred Shares are usually limited in number and of small nominal value. They are generally issued fully paid to the original vendors or their nominees, in consideration either of part of the purchase price or of services connected with the formation of the Company. Generally they only rank for dividend after other classes of shares have received certain rates of dividend, when they are entitled to the whole or a portion of the surplus Profits. In some instances shares of this nature are termed Management Shares.

Holders of Founders' Shares are inclined to call for their full dividend in prosperous years, with the result that the Company may not place adequate amounts to Reserve for the purpose of equalising dividends in future years, or strengthening the general financial position; but usually the Directors have power to put to Reserve before the payment of any Dividend, and where this is so, they can place so much

of the Profits of any year, as they think fit, to Reserve, even though this may have the effect of preventing the payment of any dividend on the Founders' Shares (*Fisher v. Black & White Publishing Co.* 1901, 1 Ch. 174).

(4) *The Distinction between Stock and Shares.*

The chief differences are as follows:—

- (a) Stock must be fully paid up; whereas Shares need only be partly paid up.
- (b) Stock may be issued or transferred in fractional parts; Shares cannot be divided below the nominal value of each Share.

Under § 41 of the Companies (Consolidation) Act, 1908, a Company can convert all or any of its paid up Shares into Stock, and reconvert that Stock into paid up Shares of any denomination.

(b) *Shares issued for Cash.*

In order to vouch shares issued for cash, the following procedure will be necessary:

- / (1) Check the application and allotment letters with the application and allotment book.
- / (2) Check the Shares allotted, and the amounts payable on application and allotment, from the Application and Allotment Books into the Share Ledger.
- / (3) Check cash received on application and allotment with the Pass Book; check the Shareholders' Cash Book in detail into the Share Ledger, and in total into the Application and Allotment Accounts.
- / (4) Where applications have been returned owing to allotment not being made, vouch repayment of cash with the Application and Allotment Book.

- / (5) Examine the Minute Book to see that all allotments have been made the subject of a minute, and where only the total number of Shares allotted on any day is referred to in the Minutes, see that the Application and Allotment Book has been initialled by a Director up to the point referred to in the Minutes.
- / (6) Similar procedure should be adopted to verify the proceeds of calls.
- / (7) See that the issue is within the limits authorized by the Memorandum and Articles of Association.
- / (8) See that the provisions with regard to the minimum subscription (if any) have been complied with.
- / (9) Vouch the Journal entries relating to the issue of Shares, and check the postings.
- / (10) Check the balances on the Share Ledgers, and see that the total agrees with the total Capital issued.
- / (11) Check the balances on the Shareholders' cash accounts in the Share Ledger, and see that they agree with the balances shown as outstanding on the Application and Allotment and Call accounts.

(c) Shares issued for other Consideration.

The issue of Shares to a Vendor in part payment of the purchase consideration will be vouched by reference to the Contract between the Company and the Vendor, and the Minutes recording the allotment. Such contracts must be filed with the Registrar of Companies within one month after allotment, and the Auditor should ascertain whether this has been done.

The effect of non-registration has been dealt with in Chapter VII., § 26.

Frequently Shares are issued to the nominees of the Vendor, either by virtue of a supplementary agreement or under a written nomination by the Vendor in favour of his nominees. The issue of such Shares will be vouched by reference to these documents.

Shares are sometimes issued as fully paid to persons in consideration of the payment by them of part or the whole of the preliminary expenses of the Company; the issue of such Shares will be vouched in the same manner as the Vendor's Shares.

Payment of Underwriting Commission, or Commission on placing Shares, is usually effected by cash, but is sometimes discharged by the issue of fully paid Shares. The Auditor's duties in connection with the vouching of payments of this nature are considered in § 6, and assuming the issue of such Shares to be in order, the vouching of the issue will be carried out in the same manner as above described.

Power is sometimes taken by a Company to issue bonus Shares, fully paid up, to all persons subscribing to any particular issue of Capital. This is a form of Commission on placing Shares, and the Auditor should see that a proper Contract is in existence, constituting the title of the allottees to such bonus Shares.

The Auditor should vouch the Journal entries relating to Shares issued for consideration other than cash with the Contracts and the Minute Book. The Shares allotted should be checked into the Share Ledger.

Shares are sometimes issued to Vendors or others partly paid in part consideration of purchase price. This particularly applies in Reconstructions where further capital is required, and Shares in the new

Company are issued partly paid to the Shareholders in the old Company.

(d) Shares issued at a Premium.

Shares may be issued at a premium, and where this is done the Auditor should see that the amount received in respect of the premium is placed to the credit of the Premium on Shares Account and not to the credit of the Share Capital Account.

Unless the Articles provide otherwise, there is nothing to prevent a Company utilising such premiums for payment of dividends, or treating them as revenue profits; but it is very inadvisable that this should be done. The premiums are not trading profits and, if treated as profits of the year in which the Shares are issued, will have the effect of increasing the profits of that year in a manner which cannot be maintained in succeeding years.

From a financial point of view, the effect of treating such premiums as revenue profits is important. As a rule, Shares can only be issued at a premium because high dividends have been paid in the past on capital already issued and it is expected that similar high dividends will be paid on the Shares about to be issued. If, however, the premium on these Shares is immediately distributed as dividend, and only the amount represented by the nominal value retained in the business as working Capital, it is improbable that by the use of such Capital the high rate of dividend previously declared will be earned on the additional Shares issued.

The usual practice is to transfer the amount received in respect of premiums to the credit of the General Reserve Account, but it may be utilised in writing

off the preliminary expenses relating to the issue, or in writing down the goodwill or other fixed assets.

(e) Share Books.

Under § 25 of the Companies (Consolidation) Act, 1908, every Company is obliged to keep a Register of Members, and sometimes the Share Ledger is so arranged as to fulfil the requirements of this Section. It is also usual to find a Register of Transfers, recording particulars of all transfers registered by the Company, although in some cases this book is dispensed with, and the entries made direct from the transfers into the Share Ledger.

The question as to how far it is the duty of the Auditor to examine these books, on the occasion of each Audit, is important. It has already been stated that on the occasion of any issue of Share Capital, the Auditor should check the entries relating thereto into the Share Ledger. His duty is to vouch the Balance Sheet of the Company, and, in order to ascertain that the issued Capital as stated therein is correct, he must vouch such issue in detail; but once this has been done, it is immaterial to the Auditor whether the Capital is held by one or another individual Shareholder, and he need not, therefore, check Share transfers in detail. He should, however, check the balances on the Share Ledger on the occasion of each Audit, and see that the total agrees with the issued Capital as shown in the Balance Sheet, since if shares had been fraudulently issued and entered in the Share Ledger, the Auditor might be held responsible if he failed to discover the fraud, owing to his omission to check the balances on this book.

When the transactions in the Shares of a Company are numerous, the receipts from Transfer Fees will be a considerable item. In any case these receipts must be vouched by the Auditor, either by reference to the Transfer Register or by counting the transfers.

'(f) Share Transfer Audit.'

It does not form part of the Auditor's duties in the ordinary course to check the Share transactions in detail, but he is frequently employed by the Directors to perform this work at a special fee. Such an Audit is termed a Share Transfer Audit and its object is the prevention of clerical errors, or the issue of duplicate shares, whether fraudulently or otherwise.

The Auditor should ascertain that all Transferors have been notified of the lodgment of transfers, and enquire as to whether any objections have been received. The signatures on the transfers should be examined with previous transfers or application forms, and it should be seen that the transfers are duly executed and stamped. The distinctive numbers of the Shares should be checked with the Transferor's account in the Share Ledger and with the Certificate lodged with the transfer, which should be cancelled. Where part of a holding is transferred it is sometimes the practice to issue Balance Certificates, when it should be seen that the distinctive numbers thereon represent the balance of Shares untransferred. An alternative method is to endorse the Shares transferred on the back of the original Certificate. The new Certificates and Balance Certificates (if any) should be checked and initialled by the Auditor, and it should be seen that the counterfoils thereof are correctly entered. The entries in the Transfer Register should also be checked.

On the occasion of his next visit the Auditor should examine the Minute Book to ascertain whether the Board have passed all transfers previously examined by him, and, if so, he should check the entries from the Share Transfer Register into the Share Ledger.

(g) **Forged and Blank Transfers.**

In the event of a forged transfer being passed by the Company, the alleged Transferee acquires no rights even though a certificate has been issued by the Company, and the Company may remove the name of the Transferee from the Register (*Simm v. The Anglo-American Telegraph Co.*, 1879, 5 Q.B.D. 188); but the Company will be liable to the true owner and can be compelled to replace his name on the Register and restore to him his Shares, paying him any dividends which he may have lost in the meantime (*Barton v. L. & N. W. Railway*, 1890, 24 Q.B.D. 77).

Where the Company acts on a forged transfer and registers the Transferee, issuing to him a Certificate, and a third party has purchased the Shares from such Transferee on the faith of the Certificate, the Company will be liable to make good any loss which such purchaser may have suffered owing to the Shares being claimed by the real owner (*Bahia & San Francisco Railway Co.*, 1868, 3 Q.B. 584).

Where, however, a Secretary fraudulently and without the authority of the Directors affixed the Seal of the Company to Share Certificates, having forged the signatures of two of the Directors and issued such Certificates apparently in the ordinary course of business, it was held that the Company was not liable to the holders of such Certificates for valuable

consideration (*Ruben v. Great Fingall Consolidated Co.*, 1906, A.C. 439).

A person who lodges a forged transfer in good faith and procures the issue of a fresh Certificate is liable to indemnify the Company (*Sheffield Corporation v. Barclay*, 1905, A.C. 392).

Under § 27 of the Companies (Consolidation) Act, 1908, no notice of any Trust may be entered on the Register; but if the Directors are aware that a transfer is being made in breach of trust or for the purpose of defrauding any person having equitable rights in the Shares, they may become personally liable if they pass the transfer without notifying the person interested, although the Company is under no liability (*Société Générale v. The Tramways Union*, 1885, 14 Q.B.D. 424).

Blank transfers are frequently deposited by way of security for an advance, accompanied by a Share Certificate. The transfer is signed by the Transferor, but the name of the Transferee and the date of execution are omitted, not being inserted until it is desirable to register the transfer. A Company can take no cognizance of a blank transfer, but such a procedure may give a good equitable security upon the Shares, whether the Company does or does not require transfers to be by deed (*Société Générale v. Walker*, 1886, 11 A.C. 20).

Where the regulations of the Company do not require that the transfer shall be by deed, it may be effected by writing under hand, *i.e.* by mere signature of the parties to it; and in the case of a blank transfer, if the holder improperly fills in his own name, the title in the Shares does not pass. If the transfer is passed on in blank to another person, who subsequently fills it up, the latter can only claim the same rights as the original holder, since the fact that he received the

transfer in blank was equivalent to notice that an absolute sale had not been effected (*France v. Clark*, 1884, 26 Ch. 257; *Fox v. Martin*, 1895, W.N. 36).

Where the holder of a blank transfer, acting improperly, inserts the name of the Transferee, and such Transferee takes the Shares for proper consideration and without notice of any fraud or irregularity, his title is valid against the original holder (*Sheffield v. London Joint Stock Bank*, 1888, 13 A.C. 333; *London Joint Stock Bank v. Simmonds*, 1892, A.C. 201); but until the title of such purchaser is completed by registration, the title of the true owner holds (*Ireland v. Hart*, 1902, 1 Ch. 522). A blank transfer cannot, therefore, be said to afford absolute security to the holder.

If transfer is required by deed, the document is not complete until the Transferee's signature and date of execution are inserted, so that although it may give the Transferee an equitable title, it does not give a legal title (*Ireland v. Hart*, 1902, 1 Ch. 522; *Société Générale v. Walker*, 1886, 11 A.C. 20).

If the Transferor, for the purpose of defrauding the holder of the blank transfer, executes another transfer, such Transferee will have a good title to the Shares on registration of his transfer and the blank transfer may be defeated (*Peat v. Clayton*, 1906, 1 Ch. 659).

The fact that most Companies note on their Share Certificates that no transfer will be registered without production of the Certificate, does not apparently prevent a Company issuing duplicate Certificates in place of those lost or defaced, and most Companies take power to issue such duplicates under their Articles, a letter of indemnity from the holder being usually required. It would not be a difficult matter for the

Transferor who has signed a blank transfer and deposited his Share Certificate as security for an advance, to obtain from the Company a duplicate Certificate, under a misrepresentation that he had lost his original Certificate, and then to execute a fresh transfer, selling the Shares on the faith of the duplicate Certificate so issued.

For this reason, in most cases, the lender on the security of Shares requires the transfer to be completed and his name registered as the holder of the Shares.

/ (h) Forfeited Shares.

If any Shares have been forfeited, the Auditor should examine the Minutes dealing with the matter and ascertain that due notice of forfeiture has been given to the Shareholder, in accordance with the Articles. Although in certain cases the original holder may be liable for calls notwithstanding the fact that his Shares have been forfeited, it is not usual to treat such calls as in arrear, and only the actual cash received on account of the forfeited Shares is placed to the credit of the Forfeited Shares Account. This should be shown separately in the Balance Sheet, until the Shares have been re-issued, when, if the total amount received in respect of the Shares is more than the nominal value thereof, the final balance standing to the credit of the Forfeited Shares Account may be transferred to the Reserve Account. It is not advisable that it should be placed to the credit of the Profit and Loss Account; although, unless the Articles state otherwise, there is nothing to prevent this.

(i) Calls Paid in Advance.

" Directors may receive moneys from Shareholders in advance of calls. Under Table " A " power is given

to pay interest on amounts so advanced, and such interest is a charge against the profits and can be paid out of capital. Calls paid in advance do not form part of the Share Capital, and should be shown separately in the Balance Sheet. In the event of winding-up they are repayable before any return is made in respect of called-up capital (*In re Wakefield Rolling Stock Co.*, 1892, 3 Ch. 165).

(j) Interest Payable out of Capital during Construction.

Under § 91 of the Companies (Consolidation) Act, 1908, where shares are issued for the purpose of raising money for the construction of works, buildings, or plant which cannot be made profitable for a lengthened period, a Company may pay interest on so much of such Capital as is for the time being paid up, and charge the same to Capital as part of the cost of construction, subject to certain restrictions specified in the section. The Accounts of the Company must show the Share Capital on which, and the rate at which, interest has been paid out of Capital.

Interest on Debentures issued for a similar purpose can be charged to Capital during the period of construction (*Hinds v. Buenos Ayres Grand National Tramways Co., Ltd.*, 1906, 2 Ch. 654).

(k) Alteration or Reduction of Share Capital.

Share Capital can be altered or reduced under §§ 40-46 of the Companies (Consolidation) Act, 1908, the operations of which have been considered in Chapter VII., §§ 8-11.

Where the Company is acting under a Special Resolution, the Auditor should examine the same, and ascertain that it is in order; and where the consent of

the Court is required, the Auditor should also examine the Order of the Court. This will enable him to vouch the necessary journal entries recording the alteration or reduction of Capital.

Where the scheme involves an alteration in the number of Shares held by each Shareholder, or in the nominal amount of such Shares, or the conversion of one class of Shares into another class, the Auditor should check the necessary entries; and where new Share Ledgers have been opened, he should ascertain that each Shareholder is duly credited with the amounts to which he is entitled.

§ 3.—Mortgages.

A Mortgage is a conditional transfer of property made for the purpose of securing repayment of a loan with interest at a given date. Until default is made in the terms of the deed, either as regards the payment of interest or repayment of principal, or in any other way, the Mortgagor (*i.e.* the borrower) retains possession and use of the property.

Mortgages affecting the property of the Company as defined in § 93 of the Companies (Consolidation) Act, 1908, must be registered with the Registrar of Joint Stock Companies in the same manner as in the case of debentures referred to below.

The Auditor should vouch the receipt of the loan and examine the Register of Mortgages in which particulars of the loan must be inserted under § 100 of the Companies (Consolidation) Act, 1908. In the Balance Sheet the loan should be shown separately on the liability side and a note made of the asset by which it is secured. Sometimes the method is adopted of

deducting the amount of the Mortgage from the asset, and only extending the surplus on the asset side of the Balance Sheet; but this is not desirable, as it has the effect of obscuring the total of the Company's liabilities.

When assets have been specifically charged and the Directors do not insert a note on the Balance Sheet stating this fact, the Auditor should endeavour to arrange that this should be done; but in the event of their refusing to admit it, he must refer to the facts in his report to the Shareholders, as a charge of this nature undisclosed materially affects the correctness of the Balance Sheet.

§ 4. -Debentures.

(a) Definition of Debenture.

A Debenture is a written acknowledgment of a debt by a Company under Seal, containing provisions as to payment of interest and repayment of principal. It may be either a Simple or Naked Debenture, carrying no charge, or a Mortgage Debenture, carrying either a fixed or floating charge on some or all of the assets of the Company, either including or not, as the case may be, the uncalled Capital of the Company.

Under § 93 of the Companies (Consolidation) Act, 1908, all mortgages and charges affecting the property of the Company, as defined in that Section, must be registered within 21 days after the date of creation with the Registrar of Joint Stock Companies, otherwise they will be void against the Liquidator and any Creditor of the Company, so far as the security comprised by the charge is concerned. If so rendered

void, the principal moneys will immediately become repayable.

Under § 100, the necessary entries must be made in the Register of Mortgages kept by the Company.

Debentures either take the form of Bonds to Bearer, or they may be registered in the names of the holders, transmission being by transfer. In the latter case, a Debenture Register or Ledger must be kept.

Debenture Stock may also be issued, the distinction between Debentures and Debenture Stock being similar to that between Shares and Stock. Usually, Debenture Bonds cannot be divided and must be transferred entire ; but Debenture Stock can be transferred in whole or part, subject to any fractional limitations imposed at the time of issue.

On the issue of a series of Debentures by a Company, it is usual for two or more persons to be appointed as Trustees for the Debenture Holders for the purpose of acting generally on their behalf. Where this is the case a fee is usually payable by the Company to the Trustees for their services.

(b) Issue of Debentures.

Where a series of Debentures are issued, the procedure is similar to that in the case of an issue of Shares, and the work to be performed by the Auditor in vouching the issue will be of the same character.

When Debentures are issued for cash, the receipt of the cash must be vouched. Frequently Debentures are issued to Vendors as fully paid in part payment of purchase consideration, and in such cases the Auditor must examine the Contracts under which the issue is made.

The Auditor should examine a copy of the Debentures, or the Trust Deed under which they are issued, in order to ascertain the terms and conditions of issue.

The Memorandum and Articles of Association should be examined to ascertain the borrowing powers of the Company. This question has been discussed in Chapter VII., § 31.

The Auditor should ascertain that the Debentures have been duly registered with the Registrar of Joint Stock Companies, and should examine the entries relating thereto in the Register of Mortgages.

Debentures may be issued at par, at a discount, or at a premium; and may be repayable at par or at a premium. Special points arise in each case, which demand consideration:—

(1) *Debentures issued at a Premium.*

When Debentures are issued at a premium, the premium may be dealt with in various ways. Unless the Articles provide otherwise, or the conditions of the issue specifically state the manner in which the premium is to be applied, it can be treated as a revenue profit, and distributed as dividend; but it is undesirable to deal with it in this way, as it is not an ordinary trading profit. It may either be placed to Reserve Account or utilised to form the basis of a Debenture Redemption Fund; or, if not employed in this manner, it may be used to write off fictitious assets or to write down the value of fixed assets. It is usual to charge the expenses of issuing the Debentures against the premium received.

In the Balance Sheet the Debentures will appear as a liability at their nominal value.

(2) *Debentures issued at a Discount.*

Unlike Share Capital, Debenture Capital can be issued at a discount, and the discount can be regarded as a lump sum allowed to the lenders at the time of their taking up the Debentures, in consideration of a lower rate of interest being payable than would have been the case had the Debentures been issued at par. The financial position of the Company and the state of the money market at the date of issue are important factors in determining the price of issue.

The Debentures will appear in the Balance Sheet as a liability at their nominal value, and the discount will be written off over a period of years, the balance remaining at any date being carried forward in the Balance Sheet, and shown separately as such under § 90 of the Companies (Consolidation) Act, 1908. Under § 26 of the same Act, any sums paid by way of commission in respect of the issued Debentures, or allowed by way of discount, must be stated in the Annual Summary.

As this discount does not represent any available asset, it is very advisable that it should be written off as soon as possible. It cannot be said, however, to be incorrect to write off the discount over the term of the Debentures; and in that case, when no Sinking Fund is formed for the purpose of repaying the Debentures and the Debentures are repayable at the end of a given period, an equal amount of the discount should be written off each year. If the Debentures are repayable by annual drawings, without the provision of a Sinking Fund, the discount should be written off in relative proportion to the amount of Debentures outstanding, in order that the periods enjoying the use of the greater portion of the Debentures

should be charged with the greater portion of the discount.

Where the redemption of the nominal amount of the Debentures repayable is provided for by annual charges against Profit and Loss, such charges will include the provision for discount, and, consequently, the discount can be written off against the credit balance of the Redemption Account.

(3) *Debentures repayable at a Premium.*

These Debentures will appear in the Balance Sheet as a liability at their nominal amount, with a note of the amount at which they are repayable, any discount or premium on issue being treated in one of the ways described above.

If a Sinking Fund is formed to provide for repayment, the same should include provision for the payment of the premium on redemption. If no Sinking Fund is formed, the premium should be provided for out of profits over the term of the Debentures.

(4) *Debentures issued as Collateral Security for a Loan.*

It is a common practice for Companies to issue their own Debentures as collateral security against a loan or overdraft from a Bank or other parties. Section 104 (3) of the Companies (Consolidation) Act, 1908, expressly refers to this procedure, and provides that such Debentures shall not be deemed to have been redeemed by reason only of the account of the Company having ceased to be in debit whilst the Debentures remained so deposited.

The term collateral security means a security which can be realised by the party holding it, in the event

of the original loan in respect of which the security was given not being repaid at the proper time, or in any other specific cases, according to the agreement between the parties. As soon as the loan is repaid, the collateral security is automatically released.

When Debentures are issued in this manner, they should be shown in short in the Balance Sheet, and stated as having been issued as collateral security. The loan against which they are issued will be extended as a liability in the usual way.

It is preferred by some to record the transaction by crediting the Debenture Account with these Debentures, and debiting a Debenture Suspense Account with the same amount, the latter item showing on the asset side of the Balance Sheet. When the Debentures are released, the entry is written back, and consequently will disappear from both sides of the Balance Sheet. There does not appear to be any particular advantage to be obtained in adopting this method, as the whole of the facts are clearly disclosed in the Balance Sheet by the first method of treatment described above.

(c) Redemption of Debentures.

Debentures may be redeemable according to the terms of issue, at specified dates, by annual or other drawings, or at the option of the Company, after due notice has been given of intention to repay.

The Auditor should examine the provisions of the Trust Deed, or the Debenture Bonds, relating to the redemption, and ascertain that they are duly complied with.

Where the Debentures are redeemable at the end of a given period, it is usual to find provision made

in the Trust Deed for a Sinking Fund to be raised out of profits for the purpose of redemption.

The operation of such a fund implies a charge against Profit and Loss each year of an amount which, if invested at compound interest, will produce the required sum at the end of a given period. The investments so made are usually held in the names of the Trustees for the Debenture Holders. When redemption takes place the investments will be sold and the Debenture Holders paid off. The amounts standing to the credit of the Redemption or Sinking Fund will then represent accumulated profit, but in place of being invested in specific assets, will be represented by the general assets of the business which had previously been subject to the charge of the Debentures. The amount of such fund should therefore be transferred to General Reserve. It cannot, as a rule, be used for the payment of dividends, since it may not be represented by available cash; but it may be utilised for the purpose of writing down the values of the assets if such a course is desirable.

Where Debentures have been redeemed in the open market at a discount, but the full nominal amount has been provided for by the operation of a Sinking Fund, profit on the redemption can be taken to the Profit and Loss Account, as it represents an amount previously reserved in excess of that actually required for redemption. It is, however, preferable to place the amount to Reserve.

Where no Sinking Fund has been provided any profit on redemption should be taken to reserve and not credited to the Profit and Loss Account.

In vouching the Redemption of Debentures, the Auditor should examine the cancelled Debenture Bond

or Registered Certificate, and inspect the Directors' Minute authorising the redemption.

In place of making specific investments for the purpose of redemption, it is a common practice to take out an Endowment Policy with some reputable Assurance Company, under which annual premiums are paid, the Company undertaking to provide the capital sum required, at the end of a given period. Such Policies will be assigned to the Trustees for the Debenture Holders, but the Premiums will be paid by the Company; the annual amount thereof being debited to the Profit and Loss Account and credited to the Redemption Account, while the Premiums paid will be debited to the Policy Account. The only distinction between this method and that of making specific investments is that accruing interest will not be received in cash or required to be invested. Unless some account is taken of accruing interest, the book value of the Policy will ultimately be less than the surrender value, which, in such cases, is usually the whole of the premiums paid except the first premium, together with 2 per cent. per annum compound interest.

It might be thought undesirable to include the first premium as an asset in the Balance Sheet, having regard to the fact that it is not taken account of in the surrender value; but Policies of this nature are not as a rule taken out for the purpose of surrender, and the value of the asset should therefore be looked at from the point of view of the Company as a going concern.

In order that the asset representing the Redemption Account should bear some proper relation to the facts of the case, it is convenient to increase the Policy Account by debiting it with compound interest, such interest being credited to the Redemption Account;

but it is not necessary that this should be done, as the operation does not affect Revenue. In any event, there will no doubt be some difference when the Policy matures, and any profit on the Policy represented by accumulated interest not already dealt with, should be credited to the Redemption Account, which will thus be brought up to the face value of the Policy, and be available for the purposes of General Reserve in the same manner as previously described.

Where Debentures are redeemable by annual drawings on the principle of a Sinking Fund, although it is necessary to debit Profit and Loss and credit the Redemption Account with the amount required to serve the annual drawing, it will not be necessary to invest such an amount, as the money represented thereby is immediately paid out in discharge of the drawn Debentures. The amount standing to the credit of the Redemption Account will, as soon as the Debentures have been drawn and paid off, be placed to General Reserve.

Debentures may also be irredeemable or perpetual, and specific provision is made for the legality of such Debentures by § 103 of the Companies (Consolidation) Act, 1908.

Power is granted to re-issue redeemed Debentures in certain cases under § 104 of the Companies (Consolidation) Act, 1908, which has been discussed in Chapter VII., § 34.

§ 5.—Preliminary and Formation Expenses.

This is the term given to the expenses incident to the creation and flotation of a Company. The following items are usually found :—

- / (1) Stamp duties and fees on the Nominal Capital, and stamps on the Contracts transferring the assets.
- / (2) The law costs of preparing the Prospectus, Memorandum and Articles of Association, and Contracts, and of the Registration of the Company.
- / (3) Accountants' and Valuers' Fees for Reports, Certificates, &c.
- / (4) Cost of Printing Memorandum and Articles of Association, and printing, advertising, and issue of Prospectuses.
- / (5) Cost of preparing, printing and stamping Letters of Allotment, and providing Share Certificates.
- / (6) Cost of preparing, printing and stamping Debentures and Debenture Trust Deed (if any).
- † (7) Cost of Company's Seal and original Books of Account.

These Preliminary and Formation expenses are sometimes borne entirely by the Company, and sometimes by the Vendors, or apportioned between these parties, the expenses up to allotment being payable by the Vendors, and the expenses afterwards by the Company. Care must be taken to see that the Company is only charged with expenses properly payable by it, and the Auditor must examine the Contracts relating to these expenses, and vouch the payments made. This expenditure is of a Capital nature, but as it is not represented by available assets, it is advisable that it should be written off as soon as possible out of Revenue, and this is usually performed within three or five years, the balance not written off being carried forward in the Balance Sheet as an asset.

Where premium is received on Shares issued, it is common to find the Preliminary Expenses charged against the premium received.

Underwriting Commission and Commission on placing Shares must not be included in the general heading "Preliminary Expenses," but must be shown separately on the Balance Sheet, until written off.

§ 6.—Commission on Issue of Shares.

Underwriting Commission is the amount payable to persons who undertake to subscribe for a certain number of Shares, in the event of the public not taking up the whole of the Shares offered. An underwriting contract is therefore in the nature of a speculation. If the public respond to the total extent of the Shares offered, the underwriters receive their Commission, and do not have to take up any Shares. If the public only partially respond, the underwriters have to take up the shares not subscribed for, in proportion to their contracts. It is usual for the underwriters to make formal application for the Shares they underwrite, on the understanding that allotments to them will be made only to the extent to which the public do not apply.

Commission on placing Shares is an amount payable to parties who introduce persons to the Company willing to become Members, and to take up Shares accordingly. This Commission, therefore, differs from Underwriting Commission, in so far as it is not a speculative transaction, and is only paid in the event of Capital being introduced.

Section 89 of the Companies (Consolidation) Act, 1908, empowers Companies to pay Commission of this

nature under certain conditions. The amount or rate per cent. of the Commission must be authorised by the Articles of Association, and disclosed in the Prospectus or in the Statement required to be filed with the Registrar in lieu thereof, and in any invitation to subscribe for Shares not being a Prospectus.

This Commission is usually payable in cash, but sometimes it is effected by the issue of fully paid Shares, or partly in cash and partly in Shares.

In some Companies, in place of paying Commission, an option is given to the Underwriters to subscribe within a specified period for a certain portion of the Company's unissued Shares at par or at a fixed premium, and where such Shares are likely to go to a high premium, this option may be of considerable value. It was held by the House of Lords (*Hilder v. Dexter*, 1902, A.C. 474) that such an arrangement is not an application of Shares in payment of Commission within the meaning of § 89 as quoted above. This decision overruled that given in *Burrows v. Malabale Gold Reefs and Estates Co.* (1901, 2 Ch. 23), where such an option was held to be illegal. From the ruling in the latter case, it was argued that the premium on Shares not being available in payment of Commission in this manner, was not available for revenue purposes, and therefore could not be utilised in payment of Dividends. Since the *Hilder v. Dexter* case, this argument cannot be upheld.

In order to vouch the payment of Underwriting Commission, the Auditor should examine the Articles of Association, where power is given to make payments of this nature, and should ascertain that the provisions of § 89 have been duly complied with. The Underwriting Contract should be seen and the Application

Letters signed by the Underwriters. The amount or rate per cent. paid must not exceed that authorised, and where payment has been made in Shares, it should be seen that the proper Contracts have been filed.

The vouching of Commission on placing Shares is somewhat more difficult, as it is not easy for the Auditor to satisfy himself that Commission paid to any persons is in respect of applications actually introduced by such persons. No Commission should be paid unless the Application Form on which the Shares have been allotted was initialled by the party claiming the Commission before being sent in to the Company, and the Auditor should examine the Application Forms in respect of which such Commission is payable, to ascertain whether this has been done. All Commission of this nature should be referred to in the minutes, and a Resolution passed by the Directors for the payment thereof.

Brokerage on placing Shares is an amount payable to Brokers whose clients have subscribed to Shares in the Company, on Application Forms stamped with the Broker's stamp.

Such a Brokerage, not exceeding $2\frac{1}{2}$ per cent., has been held to be *intra vires* the Company (*Metropolitan Coal Consumers Association v. Scrimgeour*, 1895, 2 Q.B. 604), and the payment thereof is not subject to the restrictions imposed by § 89. In order to vouch items of this nature, the Auditor should examine the Application Letters, ascertaining that these are stamped by the Broker concerned.

Under § 90 of the Companies (Consolidation) Act, 1908, the total of any sums paid or allowed by way of Commission in respect of any Shares, or so much thereof as has not been written off, must be stated

in every Balance Sheet until the whole amount has been written off; and under § 26 the Annual Summary must disclose the total amount of the sums (if any) paid by way of Commission in respect of any Shares since the date of the last return.

There is nothing in the Act to prevent the payment of such Commissions out of Revenue, should the Articles give power to do so; and such transactions are not subject to the restrictions imposed by § 89.

—The Statutory Audit.

This term is applied to the Audit required to be performed by the Auditor, if appointed prior to the first Statutory Meeting of the Company. Under § 65 of the Companies (Consolidation) Act, 1908, every Company must hold a General Meeting not less than one month, nor more than three months, after the date on which the Company is entitled to commence business, and such Meeting is called the Statutory Meeting.

At least seven days before the date on which such Meeting is to be held, the Directors must forward a report, called the Statutory Report, to every Member of the Company and to every Debenture Holder. This Report must be certified by not less than two of the Directors, or where there are less than two Directors by the sole Director and Manager, and must state:—

- (a) The total number of Shares allotted, distinguishing Shares allotted as fully or partly paid up otherwise than in cash, and stating in the case of Shares partly paid up the extent to which they are so paid up, and in either case

the consideration for which they have been allotted ;

- (b) The total amount of cash received by the Company in respect of all the Shares allotted, distinguished as aforesaid ;
- (c) An abstract of the receipts of the Company on account of its Capital, whether from Shares or Debentures, and of the payments made thereout, up to a date within seven days of the date of the Report, exhibiting under distinctive headings the receipts of the Company from Shares and Debentures and other sources, the payments made thereout, and particulars concerning the balance remaining in hand, and an account or estimate of the Preliminary Expenses of the Company.
- (d) The names, addresses and descriptions of the Directors, Auditors (if any), Managers (if any), and Secretary of the Company.
- (e) The particulars of any Contract, the modification of which is to be submitted to the Meeting for its approval, together with the particulars of the modification or proposed modification.

So much of the Report as relates to the Shares allotted by the Company and the cash received in respect of such Shares, and the receipts and payments of the Company on Capital Account, must be certified by the Auditors (if any) of the Company.

The work to be performed by the Auditor in connection with the Shares allotted and cash received in respect thereof, will follow the lines laid down for the Audit of the issue of Share Capital in § 2 (b) and (c) of this Chapter.

The wording of the Act relating to the Receipts and Payments Account is somewhat obscure. There can be no question that all receipts and payments of a Capital nature must be included, and it is contended by some that this is all that is required, and that Revenue receipts and payments need not be dealt with. The phrases "Receipts from other Sources" and "Payments made thereout" would seem to include Revenue receipts and payments; and the phrase "Particulars concerning the Balance remaining in hand" would seem to imply that an actual summarised Cash Account is required, showing the total receipts and payments, and balance in hand. It would appear, however, that such items as relate to Revenue need not be separately specified, but can be included in the one general heading on each side of the account, whereas Capital items must be summarised under their respective headings.

The Auditor must examine the Contracts with the Vendors, and vouch all payments; the work necessary in connection with the vouching of payments for the Preliminary and Formation Expenses and Commission on the Issue of Shares has already been discussed.

A Private Company is not required to forward a Statutory Report to the Members, or to file it with the Registrar of Joint Stock Companies or to present it to the Statutory Meeting of Shareholders (*Gardner v. Iredale*, 1912, L.J. Ch. 531).

The form of the Auditors' Certificate in connection with this Report is as follows:—

"We, the undersigned, being the Auditors of the Company, hereby certify that so much of this Report as relates to the Shares allotted, the Cash received in respect of such Shares, and the receipts and payments of the Company on Capital Account, is correct."

The following is a form of the Statutory Report of the Directors :—

THE COMPANIES ACTS, 1908 AND 1913

REPORT

(Pursuant to Section 65 of The Companies (Consolidation) Act, 1908) of

Limited,

To be certified by not less than two Directors, or by the Sole Director and Manager where there is only one and forwarded at least seven days before the Statutory Meeting to every Member and Debenture Holder of the Company, and to be filed with the Registrar of Companies forthwith after it is so forwarded Section 65, Sub-sections 2, 3, and 5, and Section 114 of The Companies (Consolidation) Act, 1908

(a) The total number of shares allotted is

(1) Here state of which
as fully paid
up or is paid
up otherwise
than in cash
to the extent
of
per share

are allotted (2)

in consideration of

and upon each of the remaining shares the sum of
has been paid in cash

(b) The total amount of cash received by the Company
in respect of the shares issued wholly for cash is £
and on the shares issued partly for cash is £

(2) Insert date,
which must be
within seven
days of the date
of the Report

(c) The Receipts and Payments of the Company on
Capital Account to (2)
are as follow

Particulars of Receipts

Particulars of Payments

The following is an account (or estimate) of the Preliminary Expenses of the Company

	£	s	d

(d) Names, Addresses and Descriptions of the Directors, Auditors (if any), Managers (if any), and Secretary of the Company

DIRECTORS

Surname	Christian Name	Address	Description

AUDITORS

Surname	Christian Name	Address	Description

MANAGERS

Surname	Christian Name	Address	Description

SECRETARY

Surname	Christian Name	Address	Description

(e) Particulars of any Contract the modification of which is to be submitted to the Meeting for its approval together with the particulars of the modification or proposed modification

We hereby certify this Report

} Two
} Directors.

We hereby certify that so much of this Report as relates to the shares allotted by the Company and to the Cash received in respect to such shares and to the receipts and payments of the Company on Capital Account is correct

} Auditors.

Dated the ____ day of _____, 19 ____

§ 8.—Adjustment of Accounts with Vendors.**(a) Purchase of Business.**

Where a Company acquires a Business from Vendors, the Auditor should vouch the Journal entries, recording the Assets acquired and Liabilities taken over (if any), with the Contracts between the Vendors and the Company. Where a Prospectus has been issued, the amount payable for Goodwill must be specified therein, and will be equivalent to the difference between the value of the actual Assets acquired and the amount of the consideration payable to the Vendors, plus the Liabilities taken over (if any).

Where the purchase consideration is less than the value of the actual Assets acquired, there will be no Goodwill, but on the other hand a surplus will be shown representing a book profit. The cost of such assets to the Company is only the amount paid therefor, and consequently any apparent surplus should preferably be utilised in adjusting the values of the assets acquired. Where, however, such treatment is not desired, the amount should be placed to the credit of a Capital Reserve Account, which will not be available for Revenue purposes.

Where a Reconstruction has taken place, and a New Company has been formed to take over from the Liquidator of the Old Company all the Assets of that Company, and possibly also to undertake certain of its Liabilities, the Old Company receiving the Purchase Consideration either wholly or partially in Shares of the New Company, the Auditor of the Reconstructed Company should examine the Contract under which the Assets are acquired, and ascertain that all such Assets are duly brought into Account.

In some cases the Liabilities of the Old Company may be wholly or partially satisfied by the issue of Shares or Debentures, and where this is so, the Auditor should vouch the issue of such Shares or Debentures, and ascertain that it is in accordance with the Contract.

(b) Apportionment of Profit prior to Incorporation.

Frequently a Company takes over a business as and from a date prior to the incorporation of the Company itself. In such an event any profits earned prior to the date of incorporation, to which the Company may be entitled, cannot be regarded as profits available for dividend, but are of a capital nature, since the Company cannot earn profits before it comes into existence. When the Vendors are not entitled to take such profits they are usually entitled to interest on the purchase consideration from the date when the business was taken over to the date when the purchase consideration is discharged. If that is so, the interest payable to the Vendors for the period from the date of taking the business over till the date of incorporation can be charged against the profits earned during that period, any interest payable in respect of any period after the date of incorporation being charged against the Profit and Loss Account. The remaining balance of profit earned prior to incorporation (if any) should either be written off the Goodwill, or, if there be no Goodwill, some other fixed asset, or carried forward as a Capital Reserve not available for Revenue purposes. *

If stock is not taken at the date of incorporation, and the exact profits thereto cannot consequently be ascertained, it is usual to arrive at the proportion of profits applicable to the period prior to incorporation,

either by apportioning the whole profits earned according to the respective periods, or in proportion to the turnover of those periods, the latter being, strictly speaking, the more correct method.

The date of the division, in these cases, should be the date of incorporation, and not the date of the certificate entitling the Company to commence business; since once that certificate has been issued the Company's power of legally carrying on business dates back to the date of incorporation.

(c) Receipts and Payments on behalf of Vendors.

In some instances, the Company does not acquire the book debts from the Vendors, but, for the purposes of convenience, undertakes to collect them on behalf of the Vendors and to pay over the proceeds. In such cases, the Company does not, as a rule, take over the liabilities either, but for similar reasons arranges to pay these liabilities out of the proceeds of the book debts. Where this is so, the assets and liabilities concerned should be brought into the books of the Company for the purpose of recording what ought to be collected and paid away on behalf of the Vendors, the book debts being credited to the Vendors and the liabilities debited. The Auditor should see that the cash received from the debtors, or the payments made to the creditors, are duly apportioned as between the Company and the Vendors. Any discounts or bad debts relating to the Vendors' book debts must be borne by the Vendors.

Sometimes the Company takes over the book debts, which are guaranteed by the Vendors. Any bad debts incurred relating to such debts will therefore be charged to the Vendors. It is an open point

whether cash discount allowed on payment of such debts within the usual term of credit can be so charged ; but this will depend on the precise wording of the contract with the Vendors. The Auditor should take care to ascertain that all losses properly chargeable against the Vendors are debited to them.

The Vendors' Contract should be consulted to ascertain whether there are any provisions other than those above referred to affecting the adjustment of the accounts between the Vendors and the Company. It is sometimes arranged that the Vendors shall account for all moneys withdrawn from the business between the date from which the Company acquires it and the date when the Company takes it over, and in the same manner any sums paid into the business during that period, by the Vendors, may be repayable to them.

—Directors.

Liability of Directors to Account.

The relation between the Directors of a Company and the Company itself has been defined by Lord Selbourne, in *G.E.Rly. Co. v. Turner* (1872, 8 Ch. 149), when he said : "The Directors are the mere Trustees or Agents of the Company—Trustees of the Company's money and property : Agents in the transactions which are entered into on behalf of the Company."

As such, Directors are liable to account to the Company for the assets which have come into their hands or are under their control.

Directors therefore occupy a fiduciary position, and cannot make any profit out of the Company beyond the remuneration to which they are entitled. Unless

the Articles expressly make provision that Directors can enter into Contracts with the Company, no Director can enter into such a Contract, nor can Contracts be made in respect of which Directors are interested; and if § 77 of Table "A" applies his office is vacated by any Director so concerned. This rule however does not prevent a Director taking up Shares or subscribing to Debentures in the usual way.

Any Contracts so made are liable to be set aside, and a Director must account to the Company for any profits made by him in this connection. As, however, it might be disadvantageous to the Company if it were not able to make contracts with its Directors, the Articles usually provide that Directors may enter into Contracts with the Company without rendering themselves liable to account for any profits in consequence. Unless such a power is given, the Auditor should carefully note any Contracts entered into by the Company with its Directors, as it may be his duty to inform the Shareholders of the facts.

The fact that Directors occupy a fiduciary position renders it necessary that any amounts owing by them to the Company should be shown separately on the Balance Sheet, and any payments to them for remuneration or otherwise should be disclosed in the accounts presented to the Shareholders.

Some Directors consider that they are entitled to borrow from the Company, or to overdraw their salary or remuneration. Such a procedure is wholly irregular, unless special powers are given by the Articles, or by the Shareholders in General Meeting. The Auditor should clearly point out that the Directors are, as far as the funds of the Company are concerned, the Trustees of the Company, and are not entitled to

borrow or overdraw in respect of moneys subject to their trust. Where, however, this has been done, the Auditor must point it out to the Shareholders in his Report.

The liability of Directors under § 215 of the Companies (Consolidation) Act, 1908, for Misfeasance or Breach of Trust in the event of winding-up, has been considered in Chapter VII., § 39.

(b) Remuneration of Directors.

Directors are not entitled to remuneration unless the Articles of the Company provide for the payment thereof, or the Shareholders in General Meeting resolve to pay such remuneration. The Auditor should therefore examine the Articles to ascertain whether the remuneration is fixed thereby, and, if not, he must ascertain by reference to the Shareholders' Minute Book whether any Resolution has been passed under which the Directors are entitled to remuneration.

Directors' Remuneration may take the following forms :—

- (1) A sum, fixed by the Articles, divisible among the Directors each year, as they may themselves determine.
- (2) A sum, fixed by the Articles, payable to each Director, and an additional sum payable to the Chairman.
- (3) A fee, fixed by the Articles, to be paid for each Meeting attended, or the remuneration payable to the Directors as a whole to be apportioned according to the attendances of each.
- (4) A sum equal to a percentage on the profits of the Company, either with or without the addition of a fixed remuneration.

- (5) An amount voted by the Shareholders in General Meeting, and divisible between the Directors according to the Resolution.

In order to vouch the remuneration paid under the first method, the Auditor should examine the Articles and the Resolution of the Directors determining in what manner the remuneration is to be divided.

In the second case, the authority would be found in the Articles, and no Resolution of the Directors is necessary.

In the third case, the Auditor should examine the Directors' Attendance Book, and see that the fees paid to each Director are properly calculated according to the number of his attendances.

In the fourth case, the Articles must be examined by the Auditor in order to ascertain the manner in which the percentage of the profits payable to the Directors is to be arrived at. Unfortunately, in many cases, the Articles do not clearly define the manner in which the percentage is to be calculated, and in cases of dispute it is advisable that the definition given in the Articles should be amplified by Resolution of the Shareholders in General Meeting. Where the Directors are entitled to a percentage on the net profits of the Company, the question arises as to whether the term "net profits" means the profits after charging such remuneration, or the profits before charging the same. Although such percentage is a charge as far as the Shareholders are concerned, it is an appropriation of the profits as far as the Directors are concerned, and should, in the absence of clear indication in the Articles to the contrary, be based on the profits before charging the percentage.

A further point arises in connection with the treatment of Income Tax. Income Tax is legally an appropriation of profits, but so much thereof as cannot be recouped from shareholders, debenture holders or others, is treated as a charge in the Accounts of the Company.

It has been decided that where a manager of a Company is entitled to a percentage of net profits, income tax must not be charged before arriving at the sum upon which the commission is to be calculated. (*Johnston v. Chestergate Hat Manufacturing Co.*, 1915, L.J. 84, Ch. 915.) It was held in this case that income tax is part of the net profits available for dividends, and the phrase "net profits" in the particular case in question was defined in the Agreement to mean "the net sum available for dividends as certified by the Auditors"

The Court followed the ruling in *Attorney-General v. Ashton Gas Company* (1907, L.J. 73, Ch. 673) where it was held that income tax is part of the profits, viz., such part as the Revenue is entitled to take of the profits.

It will be noted that the Agreement provided that the Auditor's certificate of the amount upon which the commission was to be paid, was to be taken as final, but the Court held that where such a certificate is based on a wrong principle, it is not conclusive and binding on the parties.

Any specific reserves made to provide for anticipated losses, or any compulsory appropriation of profits such as, the provision of a Sinking Fund for the Redemption of Debentures obligatory on the Company under the provisions of the Issue, must be charged before arriving at the amount of profits on which the percentage is

calculated; but appropriations to General Reserve, or Reserves for Equalising Dividends, should not be charged.

Where the remuneration is based on the "net trading profits" losses or expenses not arising in the ordinary course of trading, income tax, or compulsory appropriations of profit, should not be debited, but on the other hand interest and dividends received on investments, or any profit not arising in the ordinary course of trading, should not be credited.

Remuneration based on a percentage of profits does not include a percentage of the profits made "on the sale of the whole undertaking of the Company (*Frames v. Bultfontein Mining Co.*, 1891, 1 Ch. 140); but in the absence of special stipulations to the contrary, "profits," in cases where the rights of third parties come in, mean actual profits, and not necessarily the profits as shewn by the Profit and Loss Account. (*In re Spanish Prospecting Co.*, 1911, L.J. Ch. 210.)

Where the remuneration is voted by the Shareholders in General Meeting, the Auditor must examine the Shareholders' Minute Book. Such a remuneration is in the nature of a gratuity and not an amount to which the Directors are entitled by right, even although the Articles may state that the remuneration of the Directors shall be fixed by the Company in General Meeting (*Hutton v. West Cork Railway Co.*, 1883, 23 Ch. D. 654).

It is a misfeasance on the part of a Director to take remuneration in excess of the amount that is payable, and any Directors who are parties to such payments are jointly and severally liable to refund the amount (*Leeds Estate Co. v. Shepherd*, 1887, 36 Ch. 809: *Re Whitehall Court*, 1887, 56 L.T. 280).

The Company, however, can ratify the payment of remuneration in excess of that prescribed by the Articles by altering the Articles or passing a Special Resolution (*Boschock Co. v. Fuke*, 1906, 1 Ch. 148).

The remuneration due to the Directors is not due to them in their character as Members and they are ordinary creditors for it and can rank with such as outside creditors (*Re New British Iron Co. ex parte Beckwith*, 1898, 1 Ch. 324; *re Al Biscuit Co.*, 1899, W.N. 115); but they may not pay themselves fees in priority to outside creditors when the funds are not sufficient to pay everyone in full (*Gas Light Improvement Co. v. Terrall*, 1870, 10 Eq. 168), or in case of the insolvency of the Company pay up their calls and utilise the money so obtained to pay their own fees (*Re Washington Diamond Mining Co.*, 1893, 3 Ch. 95).

The question as to whether a Director is entitled to any remuneration if he vacates office during the currency of a year has given rise to much discussion and several decisions have been given. Where the Directors were entitled to a lump sum, no apportionment was allowed to a Director who vacated office during the year (*Salton v. New Beeston Cycle Co.*, 1899, 1 Ch. 775); and where the provision was that each Director should be paid the sum of £300 per annum, no apportionment was allowed (*McConnell's Case*, 1901, 1 Ch. 729); and again, where the words were "The sum of £300 per annum per Director" (*Inman v. Ackroyd*, 1901, 1 K.B. 613). These decisions, however, followed that of the Court of Appeal in *Swabey v. Port Darwin Gold Mining Co.* (1889, 1 Meg. 385), which apparently was erroneously reported and they cannot, therefore, be regarded as final. It would appear that if the provision is "At the

rate of ——— per annum ” apportionment would be allowed. Owing to the uncertainty involved, it has become customary, since these cases were decided, to provide in the Articles that the remuneration shall be apportionable.

Income Tax on Directors' remuneration must not be paid out of the Company's funds unless the Articles specifically give power to do so (*Boschoek Proprietary Co. v. Fuke*, 1906, 1 Ch. 148); or unless the sum has been voted by the shareholders in General Meeting. The Assessment in respect of Directors' Fees is made on the Directors personally, and where the Fees are paid free of tax, the Company should refund to the Directors the tax borne by them.

Sometimes Directors waive the whole or a portion of their fees. In such a case the Minute Book would contain a Resolution of the Board to that effect, although all the Directors would require to be present at the Meeting, and to vote on the Resolution. A verbal agreement between the liquidator of a Company and the Directors, and by the Directors mutually with each and all the others to forego Directors' fees is valid. (*West Yorkshire Darracq Agency, Ltd. (in Liqdn.) v. Coleridge*, 1911, L.J., K.B., 1122.)

/(c) Directors' Qualification.

Unless the Articles provide that he shall do so, a Director need not hold any Share Qualification, but, where this is required, the Auditor should ascertain that the Director has duly acquired the Shares within two months after appointment, or such shorter time as may be fixed by the Articles, as required by § 73 of the Companies (Consolidation) Act, 1908. If the qualification is not so acquired, the office of Director

is vacated. A Director who acts without acquiring his qualification Shares may be entitled to his remuneration up to the date at which the office becomes vacated (*Salton v. New Beeston Cycle Co.*, 1899, 1 Ch. 775).

The Act makes no provision for vacation of office in any other circumstances, but Table "A" and the Articles of most Companies make specific regulations on this point. Vacation of office takes place automatically upon the specified event occurring and remuneration will cease accordingly (*Bodega Co., Ltd.*, 1904, 1 Ch. 276). A Director may not hold any other office of profit under the Company and the acceptance of such an office will vacate the Directorship; the appointment of a Director as Trustee for Debenture Holders, receiving a remuneration for his services, is sufficient to disqualify him (*Astley v. New Tivoli Co.*, 1889, 1 Ch. 151).

(d) Directors' Travelling Expenses.

Unless the Articles specifically provide, a Director is not entitled to travelling expenses incurred in attending Board Meetings, which are presumably covered by his remuneration (*Young v. Naval and Military Co-operative Society*, 1905, 1 K.B. 687).

It is, however, common to find a provision in the Articles entitling Directors to their travelling expenses incurred in attending Board Meetings, or otherwise on the business of the Company. The Auditor must carefully examine the clause in question since too wide an interpretation must not be placed upon it. The vouchers for payments of this nature do not usually contain details of the expenditure, and it is advisable that all such payments, being to the Directors themselves, should form the subject of a Minute. Where

the Auditor considers the payments excessive, and is unable to obtain particulars as to how they are arrived at, he should refer to the matter in his Report to the Shareholders.

Power is usually given in the Articles for the Directors, by Resolution, to vote additional remuneration to any Director who is called upon to travel on business for the Company, and to pay his travelling expenses. Any such payments, being authorised, are in order, but the Auditor should see that they are separately shown in the Accounts presented to the Shareholders.

(e) **Managing Directors.**

Table "A" gives power for the Directors to appoint one of their number as Managing Director or Manager and fix his remuneration, which may be by way of salary, or commission, or participation in profits, or partly in one way and partly in another, and the Articles of most Companies make similar provision. Where a Managing Director has been appointed under such powers, the Resolution of the Board appointing him and fixing his remuneration, must be examined by the Auditor, and the remuneration vouched according to the basis on which it is payable.

A Managing Director is not a clerk or servant of the Company within the meaning of the Preferential Payments in Bankruptcy Act, 1888, and, consequently, is not entitled to preferential treatment in respect of arrears of Salary or Commission in the event of winding-up (*Newspaper Proprietary Syndicate*, 1900, 2 Ch. 349). A Secretary of the Company, however, who devotes the whole of his time to the services of the Company, can claim preferential rights (*Cairney v. Bach*, 1906,

2 K.B. 746), and so also can a Director in respect of Employment, who is authorised by the Articles to accept such employment in the Company (*Re Beeton & Co., Ltd.*, 1913, L.T. 160).

§ 10.—Minute Books.

(a) Directors' Minute Book.

Under § 71 of the Companies (Consolidation) Act, 1908, every Company must cause Minutes of all proceedings at Meetings of Directors or Managers to be entered in a Minute Book. Any Minute purporting to be signed by the Chairman of the Meeting, or by the Chairman of the next succeeding Meeting, is evidence of the proceedings.

The Auditor should peruse the Minute Book and should see that all Minutes which he is utilising as evidence of transactions are duly signed, and that the names of the Directors present at the Meeting have been inserted. The Auditor should refer to the Minute Book in vouching all transactions other than those connected with the usual trading operations.

The following are instances of transactions of a special nature :—

- (1) Allotment of Shares.
- (2) Adoption of Contracts.
- (3) Power to utilise the Company's Seal.
- (4) Making Calls.
- (5) Forfeiting Shares.
- (6) Appointment and Remuneration of Managing Director, Manager, Secretary, or other officials.
- (7) Appointment of Auditors prior to Statutory Meeting, or to fill a casual vacancy, and their remuneration.

- (8) Authorisation of Capital Expenditure.
- (9) Resolution to pay interim Dividends where such are *intra vires*.
- (10) Payment of Travelling Expenses to Directors or Special Remuneration.
- (11) Adoption of Accounts.
- (12) Adoption of Directors' Report to Shareholders and Recommendations as to Division of Profits.

(b) Shareholders' Minute Book.

Under § 71 of the Act quoted above, Minutes must be made of all proceedings and resolutions at Shareholders' Meetings, and entered in the Shareholders' Minute Book. The Auditor should examine the Minutes of each Meeting, particularly with reference to the following matters :

- (1) Adoption of Accounts.
- (2) Appropriation of Profits by way of Dividends, and amounts placed to Reserve, &c.
- (3) Voting Remuneration to Directors.
- (4) The election of Auditors and their remuneration.
- (5) Any Resolutions affecting the Accounts.

§ 11.—Reserve Funds.

The nature of Reserves and the distinction between General and Specific Reserves has been discussed in Chapter IV., § 8, where the question as to whether a General Reserve should be retained in the business or specifically invested outside the business is considered ; and it was there pointed out that although the term " Reserve Fund " is frequently utilised when the Reserve is not represented by specific investments outside the business, but by the general assets, it is preferable to term a Reserve so represented " Reserve

Account," and to confine the use of the term "Reserve Fund" to those cases where there are specific investments representing the fund.

Most Companies have power to put profits to Reserve before payment of any dividend, and clause 99 of Table "A" provides that the Directors may, before recommending any dividend, set aside out of the profits of the Company, such sums as they think proper as Reserve or Reserves, which shall, at the discretion of the Directors, be applicable for meeting contingencies, or for equalising Dividends, or for any other purposes to which the profits of the Company may be properly applied, and pending such application, may be employed in the business of the Company, or invested in such investments as the Directors may think fit.

It is very desirable that a Reserve Fund should be accumulated, and in some cases the Articles provide that a fixed percentage of the profits shall be retained in each year and placed to Reserve until a certain sum has been so accumulated and where this is the case, the Auditor should see that the provision is duly carried out. Such compulsory provision, however, is unusual, and commonly the Articles leave the matter to the discretion of the Directors. Where such discretion is given, it is a matter for the Directors to determine as to how much of the profits of any one year they shall put to Reserve before recommending the payment of a Dividend, even though the result of their action may be to prevent payment of any Dividend on Founders' Shares (*Fisher v. Black and White Publishing Co.*, 1901, 1 Ch. 174); or Preference Shares (*Bond v. Barrow Hæmatite Co.*, 1902, 1 Ch. 358).

In addition to appropriations of profits, exceptional profits may be placed direct to Reserve, and

amounts received for premiums on Shares issued are frequently taken to the credit of this Account. Where a Sinking Fund has been provided for the Redemption of Debentures, the amount to the credit of this Account, when the Redemption of the Debentures has been accomplished, should be transferred to the credit of Reserve and will be represented by the Assets formerly subject to the charge contained in the Debentures.

A Reserve Fund accumulated out of profits may be utilised in any manner in which the profits of the Company may be applied and can be drawn upon for payment of Dividends or to meet exceptional losses. Where a loss has been incurred on Revenue Account, such loss can be made good by a transfer from the Reserve. Any loss arising from diminution in value of the Fixed or Capital Assets of the Company may be written off against the Reserve Account.

Where the book value of the fixed Assets is less than the real value and it is desired to write up the value of such Assets in the Balance Sheet, the increase should be placed to the credit of a Capital Reserve Account, since it will not be available for Revenue purposes, but any subsequent loss in connection with these Assets may be charged against such Reserve. Before passing any entries recording the appreciation of Assets in this manner the Auditor should ascertain why the revaluation has been made, and by whom, and satisfy himself that it is *bonâ fide*. Under no circumstances should such an appreciation be taken to the credit of Revenue, unless it can be shown to have arisen by reason of excessive depreciation having been written off in the past; even then it is not desirable to credit the Profit and Loss Account, as this would have the effect of unduly increasing the profits of the

current year, and the amount should preferably be carried to the credit of Reserve.

It would appear, however, that a *bonâ fide* increase in the value of Fixed Assets can be utilised to wipe out the debit balance to Profit and Loss Account, thus leaving current profits available for the payment of dividends. (*Ammonia Soda Company v. Chamberlain* 1918, L.J. 87, page 193.) This decision is more fully referred to in Chapter X.

Where the Assets representing a Reserve are permanently employed in the business of the Company, it is sometimes desired to capitalise a portion or the whole of the Reserve, and this can be done by declaring a bonus or dividend payable out of the Reserve, free of Income Tax, by the issue of fully paid Shares.

Many prosperous companies have accumulated very large reserves, which have been used in the business, with the result that the rate of dividend paid on the issued share capital does not correspond with the rate actually earned on the capital employed in the business, and in view of political considerations, it has been thought, in many cases, advisable to bring the issued capital into a proper relation with the capital employed, by capitalising a large portion of the reserves in the way above indicated, and it is probable that the practice will become increasingly prevalent.

Where this is contemplated it should be seen that the Articles of the Company permit of such treatment, if not, they should be altered by Special Resolution; and that the Company has sufficient unissued Shares to enable this operation to be performed, as otherwise it will be necessary to increase the Capital of the Company for this purpose.

If the Shareholders do not have an unconditional

right to take their dividends or bonuses in cash should they wish to do so, this operation will probably require a Contract to be filed at Somerset House constituting the title of the allottees to the Shares under § 88 of the Companies (Consolidation) Act, 1908.

A Resolution having been passed by the Company authorizing this procedure, the Directors should pass a Resolution declaring the dividend or bonus payable out of Reserve by way of the issue of fully-paid Shares, and a Contract should be entered into between the Company and a nominee on behalf of the Shareholders under which the Shares should be allotted. Arrangement should be made for dealing with the allotment of fractions of Shares.

Sometimes this principle is utilised for the purpose of wholly or partly discharging the uncalled liability on Shares already issued. In this case the procedure is to declare the bonus or dividend out of Reserve, and at the same time to make a Call on the Shares to a corresponding amount. If the Company's Articles give power for the Call to be set off against the dividend, this can be done, but, if no power is given, the individual Shareholders must authorise the Company to retain the monies due to them for dividend or bonus in payment of the Call. This can most conveniently be done by the endorsement of the Dividend Warrant by each individual Shareholder being drawn to act as an authority to the Company to apply the amount thereof in that manner.

A dividend so distributed has been regarded as equivalent to a dividend paid in cash (*Rance's Case*, 1871, 6 Ch. 104); and it would therefore seem that there is no obligation to file any Contract at Somerset House in a case of this sort.

A Reserve Fund accumulated out of the profits remains profits in the event of liquidation, and is divisible amongst the Members in the proportion in which they are entitled to share the profits. If the Articles provide that the Preference Shareholders are entitled to profits in certain proportions and there are any arrears of Preference Dividend, Preference Shareholders will be entitled to such arrears out of the Reserve Fund (*Bishop v. Smyrna & Cassaba Railway*, 1895, 2 Ch. 265); but where the right of such Preference Shareholders to dividends only accrues after a Resolution to pay such dividend has been passed by the Directors, and the Company goes into liquidation before any such Resolution is passed, the Preference Shareholders will have no claim against the Reserve Fund in respect of arrears of dividend (*Crichton's Oil Co.*, 1901, 2 Ch. 184; 1902, 2 Ch. 86).

The ultimate distribution of surplus Assets after repaying to Shareholders the nominal amount of their Capital, whether such surplus is represented by Reserve Fund or not, must depend upon the rights of the respective classes of Shareholders as defined in the Articles.

§ 12.—Secret or Internal Reserves.

A Secret or Internal Reserve is one the existence of which is not disclosed on the face of the Balance Sheet. It is usually created in one or other of the following ways:—

- (1) By writing down Assets, such as Investments, Freehold and Leasehold Property, or Plant and Machinery, below their real value.

/ (2) By creating excessive Reserves for bad debts or other contingencies.

(3) By charging Capital Expenditure to Revenue.

/(4) By undervaluing Stock-in-trade.

/(5) By writing down the Goodwill.

The object of creating a Secret Reserve is to enable a Company to avoid violent fluctuations in its profits or dividends and so prevent any disturbance of confidence or undue variation in the value of the Shares. In the case of concerns such as Banking Companies whose whole existence depends upon the credit they enjoy and the confidence they inspire, it has been found essential to have recourse to Reserves of this nature.

The objections that may be urged against the existence of Internal Reserves which are not disclosed on the Balance Sheet, are as follows :—

(1) As the Assets are undervalued, the Balance Sheet will not show the true position of affairs.

(2) The balance of Profit available for dividends will be diminished, and consequently the Shareholders may receive a lower rate of dividend than otherwise would have been the case.

(3) The reduction in the amount of divisible Profits and the diminution of the value of Assets appearing on the Balance Sheet may cause the market value of the Shares to be less than it otherwise would have been.

(4) Such Reserves might be utilised in an improper manner by the Directors for the purpose of manipulating the Company's Shares in the market.

(5) The fact that the Assets appear in the Balance Sheet at less than their real value may be disadvantageous to the Company in the event of a fire occurring and a claim for Insurance being made.

Where Reserves of this nature are material in amount, there can be no question that the Balance Sheet will not exhibit a true and correct view of the state of affairs, and although the actual state of affairs may be much better than it appears to be, it may be desirable for the Auditor to refer to the matter in his Report to the Shareholders by indicating that the values placed upon certain Assets are considerably less than their actual values, or that the amount of Reserve made for bad debts or other purposes, appears to be in excess of what is required. Such a reference would protect the Auditor, and it would not be necessary for him to disclose the extent of the Reserves in question. In many cases, however, these Secret Reserves have been made with the direct consent of the Shareholders by means of appropriations of profit recommended by the Directors and approved by the Shareholders in General Meeting. It is common to find in the recommendations made by the Directors of a Banking Company with reference to the appropriation of Profits, that an amount is proposed to be transferred to the Bank Premises Account. This involves, to some extent, an addition to the Secret Reserves, and such appropriations passed by Shareholders are perfectly in order.

The argument that the balance of Divisible Profits is diminished and that the Shareholders will receive a lower Dividend than otherwise would be the case, cannot be maintained if the Directors are acting in a *bonâ fide* manner, and in the interests of the Company generally, since the Directors ought not to recommend the payment of any Dividend in excess of what they, in their judgment, consider should be paid. Where the requisite moneys are not retained in the business

by the operation of a Secret Reserve, it will be necessary to have recourse to an open Reserve, or the carrying forward of a larger credit balance on the Profit and Loss Account.

The fact that the published Profits appear to be less than they actually are, or that the Assets appear at a lower value than otherwise would be the case, would no doubt have some effect in reducing the market value of the Shares where the fact of the existence of such Secret Reserves is not known in the market. In the majority of cases, however, and particularly in the case of Banking Companies, the fact that such Reserves exist is perfectly well known to the bulk of the Shareholders and is to a large extent taken into account in the value at which the Shares stand in the market. Even where these facts are not generally known, as long as the Directors are acting in the general interests of the Company, they need not concern themselves with the individual interests of temporary Shareholders.

The gravest objection to which the creation of these Reserves is open, is that they may be utilised in an improper manner for the personal advantage of the Directors or their friends. It would be quite possible by charging Capital Expenditure to Revenue, or by largely undervaluing Stock-in-trade, to so reduce the Profits in any one year and the consequent Dividend, as to cause the Shares of the Company to fall in value considerably. A corresponding rise would take place in some subsequent period when the Profits were allowed to appear again at their proper amount, but in the meantime, the Company's Shares might have been dealt in very advantageously by persons commanding an intimate knowledge of the position. The

duty of the Auditor in connection with this question and the attitude which he may find it necessary to take up will be determined by his consideration of the facts of each individual case. If he is of opinion that this treatment is being utilised in a *bonâ fide* manner and for the advantage of the Company generally, he need not take objection to it, and will only refer to the matter in his Report to the Shareholders if the amounts involved are so considerable as to render it necessary. Where, however, he considers that the Shareholders ought to be informed of the facts, either because he does not think the Balance Sheet is properly drawn up, or because, in his judgment, the adoption of such a policy is not required in the general interests of the Company, he must deal with the matter in his Report to such extent as he thinks desirable.

The contention that the inclusion of Assets such as Freehold and Leasehold Property, or Plant and Machinery, in the Balance Sheet at less than their real value might be detrimental to the Company in the event of a claim being made in respect of loss arising by fire, will not stand serious examination. The Insurance Companies always require proof of the value of any assets irrespective of the value at which they stand in the books, and if it could be proved that the assets appear at less than their real value a claim for the actual value would be admitted.

In any case, it is unnecessary to actually write down the value of the asset in the books, in order to provide a Secret Reserve. It is quite possible to open a Special Reserve Account against any particular Asset, which can be deducted from the value of that Asset in the preparation of the Balance Sheet, only the net amount being disclosed, and this is the most

convenient method of providing Reserves of this nature, since recourse can be had to the Reserve without actually writing up the Asset Account in the books.

It is undesirable that any Asset of a realisable nature should be entirely written off, since if this is done, the existence of the Asset may easily be overlooked and the Auditor might omit to verify it. A debit balance of some sort should remain representing the Asset, even though it be only 1s.

The creation of a Secret Reserve by writing down the value of the goodwill is open to no objection, since this Asset is of a purely hypothetical value, and the fact that it stands at a low figure in the Balance Sheet, although the Company may be earning large profits, will only tend to strengthen the general position, and increase the value of the Shares rather than otherwise.

The case of *Newton v. Birmingham Small Arms Co., Ltd.* (1906, 2 Ch. 378), is important in connection with this subject. The Company desired to adopt additional Articles giving power to the Directors to set aside amounts out of profit, without disclosing the fact, for the purpose of constituting an Internal Reserve Fund, which should not be shown or disclosed on the Balance Sheet. The Shareholders were not to have the right to obtain information from the Directors as to the amount or application of this Fund, which might be invested in any way the Directors thought fit, or utilised in any manner which the Directors, in their absolute discretion might consider would serve, protect, or advance the interests of the Company, or preserve or promote the value of the undertaking, Assets or Goodwill of the Company. The Auditors

were to be allowed access to the Accounts relating to such fund, and it would be their duty to ascertain that the application thereof was in accordance with the provisions of the Articles, but they were not to disclose any information with regard to the Internal Reserve to the Shareholders or otherwise.

It was held by Buckley, J., that, in so far as restrictions were placed upon the Auditors in the matter of their Report to the Shareholders, the Article was *ultra vires*, as being inconsistent with the Statute, which places no limitations on the nature of the information which the Auditors might disclose to the Shareholders; but in the course of his Judgment, the learned Judge made the following remarks which particularly apply to the subject of Secret Reserves:

"Assets are often, by reason of prudence, estimated, and stated to be estimated, at less than their probably real value. The purpose of the Balance Sheet is primarily to show that the financial position of the Company is at least as good as there stated, not to show that it is not, or may not be, better. The provision as to not disclosing the Internal Reserve Fund in the Balance Sheet is not, I think, necessarily fatal to the Special Resolutions. But the Special Resolutions do not stop there. They provide that it shall be the duty of the Auditor not to disclose any information with regard to this Fund to the Shareholders or otherwise. It is, I think, inconsistent with the Act of Parliament that the Auditor shall be bound, even when he thinks that the true state of the Company's affairs is affected by facts relating to the Internal Reserve Fund, to withhold all information with regard to the same from the Shareholders. If, for instance, the Directors had invested the Internal Reserve Fund upon investments which might involve the Company under certain circumstances in enormous loss, the Act, I think, requires that the Auditor shall be at liberty and be bound to report that fact. In reporting upon the Accounts submitted to them the Auditors do not, of course, report as to the details of the Accounts to which they find no cause to take exception. Their duty is to call attention to that which is wrong, not to condescend upon all the details of that which is right. It is, I think, competent to the statutory majority of the Shareholders to say that as to particular items of their business, it is to the interest of the Corporation that there shall be secrecy and that the Auditors, who must for the purpose of their Audit know all such details, shall not, unless their duty under the Statute requires it, disclose such details to the Members. There is no suggestion in this case that these

clauses are intended to be used for any other than a legitimate purpose. Those who are engaged in commerce are familiar with the fact that undue publicity as regards the details of their trade or as to the financial arrangements, may often be injurious to traders, having regard to the rivalry of competitors in trade, to complications sometimes arising from strained relations between Capital and Labour, and the like. There are legitimate reasons for ensuring secrecy to a proper extent. It is not, I think, necessary, nor, having regard to the great utility of these Acts, is it desirable, to expose persons who trade under these Acts to the necessity of a publicity from which their competitors are free, unless such publicity is required to ensure commercial integrity. I am not disposed to look too closely for reasons why I should find clauses such as these to be inconsistent with the Act if I see that the true purpose of the Act is satisfied. I think, however, these Special Resolutions go too far. Any Regulations which preclude the Auditors from availing themselves of all the information to which, under the Act, they are entitled as material for the Report, which, under the Act, they are to make as to the true and correct state of the Company's affairs, are, I think, inconsistent with the Act."

§ 13.—Income Tax.

It is not within the province of this work to consider in detail the question of Income Tax either from a legal point of view or from the practical aspect as affecting Accounts; and the subject has been separately treated by the Authors in their work on *Income Tax in Relation to Accounts*. Moreover, it is not conceived that it is the duty of the Auditor to ascertain that the Company is correctly assessed for Income Tax. That is the duty of the Secretary and the Directors. The Auditor's duty is confined to ascertaining that the amount paid in respect of Income Tax has been properly dealt with.

It is true that in a great many Companies the Auditor is requested to prepare Accounts for Income Tax purposes, to submit the same to the Surveyor, and to conduct Appeals where necessary, but he performs this work in his capacity as Accountant, and

not as Auditor, and the matter should be subject to a separate arrangement.

The fiscal year extending from the 6th April to the 5th April rarely coincides with the financial year of a Company, and it is sometimes thought desirable to provide for the Income Tax accrued to the date of taking the Accounts, especially if these be closed at December 31st. Income Tax assessed in respect of the fiscal year ending 5th April is payable on or before the 1st of January in that year, but does not become a present liability until the 1st January. At the date of the Balance Sheet in the instance given the liability for Income Tax has not accrued due, and such Balance Sheet cannot therefore be said to be incorrect merely because it does not include provision for Income Tax, although the high rate of tax makes such a provision desirable.

• Where dividends are paid less tax the matter is not of so much consequence, since the greater portion of the tax payable by the Company will be recouped from Shareholders, Debenture Holders, and others, assuming dividends to be declared; and in fact the Profit and Loss Account will only show a debit in respect of Income Tax on profits undistributed, or payable in respect of the adjustments necessary under the Income Tax Regulations. Where, therefore, Income Tax is reserved for at the date of the Balance Sheet, the amount debited to Profit and Loss need only be in respect of so much of the tax as will be payable after allowing for the tax that will be deducted from Shareholders and others on payment of dividends and interest.

There are some instances where the accrued tax, although not paid, should be brought into the accounts.

If the date of the Balance Sheet falls between the 31st December and the 5th April, and the Income Tax then payable has not been paid, the liability should be brought in. If it is the custom to declare dividends free of tax, and the date of the Balance Sheet is prior to the 1st January, although there may be no present liability for Income Tax, the accrued tax should be calculated and brought into account, since dividends being paid free of tax no tax can be recouped from the Shareholders, and the whole of the tax payable will be chargeable against the Profit and Loss. Where the profits are large the sum payable will be considerable, and if not brought into account the balance of available profit might permit of a higher dividend being paid than would have been the case had the accrued tax been provided for. It is essential, therefore, that the Auditor should ascertain that such accrued tax has been brought into account at the date of the Balance Sheet where it is the custom of the Company to pay dividends free of tax.

The treatment of Income Tax on Directors' Fees and Remuneration has been referred to in § 9 (b) of this Chapter.

SYNOPSIS OF CHAPTER X.

Divisible Profits and Dividends.

§ 1.—THE ASCERTAINMENT OF PROFITS

2.—DEPRECIATION OF FIXED AND FLOATING ASSETS.

(a) Legal Decisions.

- (1) Lee v. Neuchâtel Asphalte Co., Ltd.
- (2) Bolton v. Natal Land and Colonisation Co., Ltd.
- (3) Verner v. General and Commercial Investment Trust, Ltd.
- (4) Wilmer v. McNamara & Co., Ltd.
- (5) Dovey v. Cory (National Bank of Wales case).
- (6) Bond v. Barrow Hæmatite Steel Co., Ltd.
- (7) Ammonia Soda Co. v. Chamberlain

(b) Legal Decisions considered.

3.—CAPITAL PROFITS

(a) Legal Decisions.

- (1) Lubbock v. British Bank of South America.
- (2) Foster v. New Trinidad Lake Asphalte Co., Ltd.

(b) Legal Decisions considered.

4.—DIVISIBLE PROFITS

5.—DIVIDENDS.

- (a) Interim Dividends.
- (b) Final Dividends.
- (c) Preference Dividends.
- (d) Arrears of Cumulative Preference Dividends.
- (e) Dividends paid out of Capital.
- (f) Scrip Dividends.
- (g) Vouching Dividends.
- (h) Unclaimed Dividends.
- (i) Provision of Moneys for the payment of Dividends
- (j) Reserves for Equalisation of Dividends.

CHAPTER X.

DIVISIBLE PROFITS AND DIVIDENDS.

§ 1.—The Ascertainment of Profits.

The proper ascertainment of profits in the case of a Company is a matter of very great importance, affecting the rights and interests of various parties in different ways. If the profits shown in the accounts have been arrived at incorrectly, and are in excess of the actual profits, and further if they have been distributed in dividend, the effect may be that the dividend has been paid out of capital in whole or in part, and that the capital fund contributed by the Shareholders does not remain intact.

Similarly such a proceeding might affect the rights of Debenture Holders since the dividend so paid away would have the result of depleting the Assets which form their security.

If the improper distribution of dividends has so depleted the funds of the Company that the remaining assets are insufficient to provide for the payment of Ordinary Creditors, the interests of the latter are obviously affected; while the Directors of the Company may make themselves personally liable to account for any dividends paid out of capital.

• Further, there may be third parties entitled to a share of the profits, such as Directors, Managers, or others, receiving a percentage thereon.

Where the profits shown are more than the actual profits, such persons might receive more than they were entitled to, while on the other hand where the profits shown are less than the actual profits, such persons may be entitled to take their proportion of the actual profits.

If the total assets of a business are valued at the commencement of the year, the difference between this sum and the total of liabilities and capital at that date represents a surplus or deficiency as the case may be. If a similar valuation is made at the end of the year and the surplus is found to have increased or the deficiency decreased, such difference, subject to any appropriations of profit or adjustments of capital, is the profit for the period, while if the surplus has decreased or the deficiency increased, such difference is the loss for the period.

It is clear that the amount of profit so arrived at is dependent upon the method employed in determining the value of the assets.

If all the assets were valued at the amount they are expected to realise if the business were closed down, a heavy loss would necessarily be shown. This method, therefore, is not adopted but the valuation is made on the basis of a going concern. It is necessary however, to distinguish between the various classes of assets, since if fixed assets representing capital expenditure such as freehold land rise in value, and this increase is taken into account, it represents an unrealised profit which may never accrue.

Fixed assets therefore are generally valued at their cost price less a proper allowance for the depreciation which has arisen as a result of their being utilised in carrying on the business.

Similarly floating assets should not be valued

above cost as this would involve taking profit before it is realised, the proper basis of calculation being cost, market or realisable value whichever is the lower.

In effect therefore the profits may be said to be the excess of current income for a given period over current expenditure after making good any loss sustained by fixed or floating assets during that period in process of earning such income.

It does not follow, however, in the case of a Company that profits so arrived at are necessarily divisible profits, and the Courts have held in certain instances that it may not be necessary to make good expired capital expenditure before arriving at the profits out of which dividends may be payable; in each case the provisions of the Memorandum and Articles of Association and their validity must be considered. It may be found on the other hand that various appropriations must be made from the Profits before any balance is available for distribution.

Before proceeding, however, to a detailed consideration of these cases, there are two decisions dealing with the ascertainment of profits which are important to note.

(a) *The Spanish Prospecting Co Ltd.* (1910, 103, L.T. 611).

In this case the Company had entered into an agreement with two men, A and B, who were to receive a salary at the rate of £41 13s. 4d. per month each, subject to the proviso that they should not be entitled to draw their salary "except only out of profits," if any, arising from the business of the Company, which might from time to time be available for such purpose. Any such salary was to be cumulative, and any arrears thereon payable out of succeeding profits.

The business of the Company included the purchase and sale of Shares; and certain Debentures which had been acquired stood in the books at no value.

The Company went into liquidation while the Debentures were still unsold, but they were subsequently realised by the Liquidator, and it was claimed that the proceeds should be credited to the Profit and Loss Account in order to enable A and B to receive their salaries out of the profits arising therefrom. Swinfen Eady, J., decided that a surplus on realised assets in winding-up, over and above the subscribed capital, was not a profit arising out of the business of the Company, but the Court of Appeal reversed the decision, and indicated that the proceeds could be properly credited to Profit and Loss Account.

Fletcher Moulton, L.J., said:—

“ . . . We start therefore with this fundamental definition of ‘profits,’ viz., if the total assets of the business at the two dates be compared, the increase which they show at the later date as compared with the earlier date (due allowance, of course, being made for any capital introduced into or taken out of the business in the meanwhile) represents in strictness the profits of the business during the period in question. But the periodical ascertainment of profits in a business is an operation of such practical importance as to be essential to the safe conduct of the business itself. To follow out the strict consequences of the legal conception in making out the accounts of the year would often be very difficult in practice. Hence the strict meaning of the word ‘profit’ is rarely observed in drawing up the accounts of firms or companies. These are domestic documents designed for the practical guidance of those interested, and, so long as the principle on which they are drawn up is clear, their value is diminished little, if at all, by certain departures from this strict definition which lessen greatly the difficulty of making them out. Hence certain assumptions have become so customary in drawing up Balance Sheets and Profit and Loss Accounts that it may almost be said to require special circumstances to induce parties to depart from them. For instance, it is usual to exclude gains and losses arising from causes not directly connected with the business of the company—such for instance, as a rise in the market value of land occupied by the company. The value assigned to trade buildings and plant is usually fixed according to an arbitrary rule, by which they are originally taken at their annual cost and are assumed to have depreciated by a certain percentage each year, though it cannot be pretended that any such calculation necessarily gives their true

value either in use or in exchange. These, however, are merely variations of practice by individuals. They rest on no settled principle. They mainly arise from the sound business view that it is better to underrate than to overrate the profits, since it is impossible for you to foresee all the risks to which a business may in future be exposed. For instance, there are many sound business men who would feel bound to take account of depreciation in the value of business premises (or in the value of plant specially designed for the production of a particular article), although they would not take account of appreciation in the same arising from like causes.

But though there is a wide field for variation of practice in these estimations of profit, this liberty ceases at once when the rights of third persons intervene. In the absence of special stipulations to the contrary 'profits' in cases where the rights of third parties come in mean actual profits, and they must be calculated as closely as possible in accordance with the fundamental conception or definition to which I have referred."

This judgment is an extremely able appreciation of the methods usually put into practice in business circles for the ascertainment of profits. While it is true that the means adopted is not a mere single entry process, nevertheless the end is to ascertain the net gain shown by the Balance Sheet over its predecessor, after allowing for depreciation on the various assets.

This case, however, was concerned with the ascertainment of profits, and not with the question of divisible profits. In fact the learned judge went on to say—

"I would have it clearly understood that these remarks have no bearing upon the vexed question of the fund out of which dividends may be legally paid in limited companies. Cases such as *Peirner v General Commercial Investment Trust* and *Lee v Neuchatel* show that this fund may in some cases be larger than what can rightly be regarded as profits, and the decisions in these cases depend largely on the fact that there is no statutory enactment which forbids it to be so."

(b) *Re Crabtree, Thomas v. Crabtree*, 1912, 106 L.T. 49.

The Testator gave his Trustees authority to carry on his business during the lifetime of his wife, and directed the profits arising from the said business to be paid to her. The Trustees, before arriving at the profits had charged the annual sum for depreciation of

machinery at the rate of $7\frac{1}{2}$ per cent. on its original value in addition to the cost of repairs, and the tenant for life contended that this ought to be disallowed. The Court of Appeal held that following *Swinien Eady, J*, such depreciation had been properly charged.

In the course of his judgment *Cozens-Hardy, M R*, said —

“But in the ordinary course of ascertaining the profits of a business where there is power machinery and trade machinery which is necessary in order to perform the work of the business, it is, in my opinion, essential that in addition to all sums actually expended in repairing the machinery, or in renewing parts that there should be also written off a proper sum for depreciation and that sum ought to be written off before you can arrive at the net profits of the business or at the profits of the business and it is not profit until a proper sum, varying with the class of machinery with the nature of the business, and the life of the machinery has been written off for depreciation”

During the argument the case of *Lee v Neuchatel Asphalte Co* was referred to, and in the course of his remarks *Buckley, L J*, said —

“The only authorities referred to were those of companies formed to work a wasting property and in such a case all profit arising from the wasting property is divisible without any deduction for the depreciation in value of the wasting property. That is because the object of the company was to acquire a wasting property and to divide all the profits. That is not so here. The profits of this business are not ascertained until a sufficient sum has been deducted to meet the depreciation of the machinery. One of the witnesses in his affidavit referred to the ‘saleable value’ of this machinery. That is not the right standard. Here it is the value of the machinery for the purpose of this business, not the saleable value.”

§ 2.—Depreciation of Fixed and Floating Assets.

The terms “Fixed,” “Floating,” and “Wasting” Assets have already been defined in Chapter IV., § 5, and the treatment of Depreciation on such Assets from a general point of view has been considered. The legal aspect of the subject as affecting Limited Companies is of great importance in determining Divisible Profits,

and has been the subject of some notable decisions. It is proposed first of all to summarise these cases, and from the consideration thereof to draw such general conclusions as may be possible.

(a) Legal Decisions.

(1) *Lee v. Neuchatel Asphalte Co., Ltd.* (1889, 41 Ch. 1).

Held that a Company, empowered to do so by its Articles of Association, may distribute Dividends without making good the Depreciation of Wasting Assets.

This action was brought by Mr. Lee on behalf of himself and all the Ordinary Shareholders of the Neuchatel Asphalte Company, with the object of obtaining an injunction to prevent the Directors of that Company from distributing a Dividend to the Preference Shareholders until depreciation of the Company's property had been provided for. The Articles of the Company provided that the Directors should not be bound to reserve moneys for the renewal or replacement of any lease, or of the Company's interest in any property or concession; though as a matter of fact the Company did from time to time write off considerable amounts, but had not made any such provision in the year during which the profit which it was proposed to distribute had arisen.

It may be remarked that in the case of a leasehold mine which cannot be exhausted during the term of the lease, the loss is continuous whether the mine be worked or not, and is a question of time and not of output; while in the case of a freehold mine the loss is one of output only. The learned judge in the remarks quoted below on this point did not refer to the element of time.

Lindley, L. J., in the course of his Judgment said (Acct. L. R. 1889, 26) :

“The respondent Company was formed for the purpose of working certain asphalte mines of which it had got a lease. It was quite obvious that with respect to such a property, every ton of stuff got out of that which was bought with capital represented a portion of capital. It was said that a division of the profit arising from the sale of such was a return of capital. If that was so, it is not, at all events, such a return of capital as is prohibited by the Company Acts. There is nothing in any of the Company Acts prohibiting anything of the kind. . . . It has been very judicially and properly left to the commercial world to settle how the accounts were to be kept. The Acts do not say what expenses are to be charged to Capital Account and what to Revenue Account. Such matters were left to the Shareholders ; they may or may not have a Sinking Fund or a Deterioration Fund, the Articles of Association may or may not contain regulations on these matters ; if they do, the regulations must be observed ; if they do not, the Shareholders can do as they like, so long as they do not misapply their capital. In this case one of the Articles provides that the Directors shall not be bound to reserve moneys for the renewal or replacing of any lease or of the Company's interest in any property or concession. . . . Now, the Companies Act, 1862, does not require the capital to be made up if lost, and it does not prohibit payment of dividends so long as the assets are of less value than the capital called up, nor does it make loss of capital a ground for winding-up. But if a Company is formed to acquire or work property of a wasting nature, e.g. a mine, quarry, or patent, the capital expended in acquiring the property may be regarded as sunk and gone, and if the Company retains assets sufficient to pay its debts, any excess of money obtained by working the property over the cost of working it may be divided amongst the Shareholders ; and this is true, although some portion of the property itself is sold, and in one sense the capital is thereby diminished. If it is said that such a course involves payment of dividends out of capital, the answer is that the Acts nowhere prohibit such a payment as is here supposed. The proposition that it is *ultra vires* to pay dividends out of capital is very apt to mislead, and must not be understood in such a way as to prohibit honest tradings. It is not true, as an abstract proposition, that no dividends can be properly declared out of moneys arising from the sale of property bought by capital. But it is true that if the working expenses exceed the current gains, profits cannot be divided, and that if in such a case capital is divided and paid away as dividend, the capital is misapplied, and the Directors implicated in the misapplication may be compelled to make good the amount misapplied. . . .”

(2) *Bolton v. Natal Land and Colonisation Co., Ltd* (1892, 2 Ch. 124).

§ *Held* that a Company may declare a Dividend out

of current profits without necessarily making good loss of capital.

The Natal Land Company, in 1882, had charged against revenue £70,000 in respect of a bad debt which had been incurred, and, at the same time, adjusted the Profit and Loss Account by crediting to it practically the same sum in respect of an increase in value attributed to lands held by them.

In 1885 a profit was made and a Dividend subsequently declared, and the plaintiff thereupon brought this action for restraining the payment of the Dividend. His argument was that the value of the land in the books was in excess of the true value, and that the difference between the book value and the actual value should be written off against profits before anything could be appropriated for the purposes of Dividend.

The Court held that, assuming a part of the capital had in fact been lost, and not subsequently made good, no sufficient ground was therefore afforded for restraining the payment of the Dividend; that the fact of the Company having written up the value of the land in 1882, and credited the increase to the Profit of that year in the manner described, did not place it under any obligation to bring into account in every subsequent year the increase or decrease in the value of its lands; and that, having regard to the case of *Lee v. Neuchatel Asphaltic Company, Limited*, it was not correct, in estimating the profits of a year, to take into account the increase or decrease in the value of the capital Assets of the Company.

It might appear that this case supported the suggestion that a Company might write up the value

of its Capital Assets to conceal a revenue loss without being obliged to charge against revenue any decrease subsequently found to have occurred owing to excessive appreciation in the past ; but it should be remembered that the Court did not have before it the question as to whether the bad debt was one that ought originally to have been charged against revenue, the learned Judge specifically stating that this point was not raised on the pleadings.

(3) *Verner v. General and Commercial Investment Trust, Ltd.* (1894, 2 Ch. 239).

Held that, subject to its Articles, a Trust Company may distribute a Dividend out of the excess of current income over current expenditure, without making good loss of Capital.

This Trust Company had issued Share Capital to the extent of £600,000, and had borrowed £300,000 on the security of Debenture Stock. The proceeds of these issues had been invested in various securities authorised by the Memorandum of Association. The market value of such securities at the date of the account was £654,776, depreciation having thus occurred to the extent of about £240,000, of which it was estimated that about £75,000 represented an amount which there was no prospect of recovering within any reasonable period of time. During the Company's last financial year the current income from Investments had exceeded the current expenditure by more than £23,000, and the question for the Court to decide was whether such excess could be utilised for the purposes of Dividend without taking into account the loss of Capital to the amount of £75,000.

Lindley, L. J., in the course of his Judgment, said:—

"The broad question raised by this Appeal is whether a Limited Company which has lost part of its capital, can lawfully declare or pay a dividend without first making good the capital which has been lost. I have no doubt it can—that is to say, there is no law which prevents it in all cases and under all circumstances. Such a proceeding may sometimes be very imprudent, but a proceeding may be perfectly legal and may yet be opposed to sound commercial principles. We, however, have only to consider the legality or illegality of what is complained of. . . . There is no law which prevents a Company from sinking its capital in the purchase or production of a money-making property or undertaking, and in dividing the money annually yielded by it without preserving the capital sunk so as to be able to reproduce it intact, either before or after the winding-up of the Company. A Company may be formed upon the principle that no dividends shall be declared unless the capital is kept undiminished, or a Company may contract with its creditors to keep its capital or assets up to a given value. But in the absence of some special Article or contract there is no law to this effect, and, in my opinion, for very good reasons. It would, in my judgment, be most inexpedient to lay down a hard-and-fast rule which would prevent a flourishing Company either not in debt or well able to pay its debts from paying dividends, so long as its capital sunk in creating the business was not represented by assets which would, if sold, reproduce in money the capital sunk. Even a sinking fund to replace lost capital by degrees is not required by law. . . . But, although there is nothing in the statutes requiring even a Limited Company to keep up its capital, and there is no prohibition against payment of dividends out of any other of the Company's assets, it does not follow that dividends may be lawfully paid out of other assets, regardless of the debts and liabilities of the Company. A dividend presupposes a profit in some shape, and to divide as dividend the receipts, say, for a year, without deducting the expenses incurred in that year in producing the receipts, would be as unjustifiable in point of law as it would be reckless and blameworthy in the eyes of business men. The same observation applies to the payment of dividends out of borrowed money. Further, if the income of any year arises from a consumption in that year of what may be called circulating capital, the division of such income as dividend without replacing the capital consumed in producing it, will be a payment of a dividend out of capital within the meaning of the prohibition which I have endeavoured to explain. . . . Perhaps the shortest way of expressing the distinction which I am endeavouring to explain is to say that fixed capital may be sunk and lost, and yet that the excess of current receipts over current payments may be divided, but that floating or circulating capital must be kept up, as otherwise it will enter into and form part of such excess, in which case, to divide such excess without deducting the capital which forms part of it, will be contrary to law. . . ."

(4) *Wilmer v. McNamara & Co., Ltd.* (1895, 2 Ch. 245).

Held that a Company can declare a Dividend out of current Profits, without making good Depreciation of Fixed Assets.

This Company made a Profit for the year ending 30th June, 1894, of £5,816 12s. 6d., before making any provision for Depreciation in respect of the value of the leases, goodwill, or plant. Depreciation had been provided on these assets to a considerable extent in earlier years, but no provision was made during the year in question. A resolution was passed by the Company to distribute the above-mentioned Profit in payment of Dividend to the Preference Shareholders. This action was taken on behalf of the Ordinary Shareholders to restrain the Directors from giving effect to the resolution, on the ground that until the loss of Capital had been made good no dividends ought to be paid.

Stirling, J., in the course of his Judgment, refusing the injunction asked for, said:—

“Clause 117 of the Company's Articles of Association provides that ‘no dividend shall be payable except out of the profits arising out of the business of the Company.’ What are these profits? . . . Apart from the use of the word ‘profits’ in clause 117, there is nothing in the Articles to show that the capital of the Company (or, rather, assets of the value of those acquired by the Company at its formation) must be kept up. Further, the Articles appear to contemplate ‘profits’ as the excess of receipts over all expenditure properly attributable to the year. It is necessary, however, to consider whether the depreciation in goodwill and leaseholds is to be treated as loss of ‘fixed’ capital or of ‘floating’ or ‘circulating’ capital, and on this point I am of opinion that it is to be treated as loss of ‘fixed’ capital. It very closely resembles the loss which a railway company may be said to suffer if it be found that their line, which was made, say, ten years ago at a certain cost, could now be made at a much smaller cost. Having regard to the remarks of Lindley, L. J., in *Lee v. Neuchatel Asphalt Company* (*supra*) I think that the Balance Sheet cannot be impeached simply because it does not charge anything against revenue in respect of goodwill. I feel much more doubt whether £200 is a sufficient sum to allow in respect of depreciation.

of leaseholds, but I do not think under the circumstances that a case has been made out for an injunction."

(5) *Dovey v. Cory* (*National Bank of Wales case*, 1901, A.C. 477).

Held that a Director, if he acts *bonâ fide*, is entitled to rely on the officers of the Company to prepare true and honest accounts.

This was an appeal from the decision of the Court of Appeal. It was sought to make the Director liable in respect of alleged misfeasance for paying Dividends out of Capital.

Wright, J., had ordered the respondent to pay £54,787, being £37,000, the aggregate amount of Dividends paid to the Shareholders in 1887, 1888, 1889, and part of the Dividend of 1890, and as to the balance, Interest at 5 per cent. per annum on each of the Dividends, holding that these Dividends were in fact paid out of Capital. Such Dividends had been paid without making proper provision for Bad Debts; had these Bad Debts been written off there would have been no Profits available for Dividend. The Court of Appeal relieved the respondent of liability on the ground that he had been deceived by persons he was entitled to trust, and that the Dividends were not in fact paid out of Capital; utilising for the latter point the arguments advanced in the *Lee v. Neuchatel* series of cases.

The House of Lords decided the case purely on the question as to whether the Director concerned was or was not justified in reposing confidence in the officials of the Company, and did not feel themselves called upon to deal with the question as to whether the

Dividends had or had not in fact been paid out of Capital.

Although, however, the House of Lords did not actually give their decision on this point, remarks were made by the Lord Chancellor (Lord Halsbury) and Davey, L. J., in the course of their Judgments, which clearly showed that they were not at all inclined to agree with the deductions drawn in the Court of Appeal from the *Lec v. Neuchatel* and other cases; and consequently doubts have been cast upon the finality of those decisions.

The Lord Chancellor said:—

“If I assume, as I do, that Mr. Cory acted upon representations made to him which he believed, and which as coming from the officers of the Bank to whom he was, in my judgment, justified in giving credit, the discussion of whether the dividends actually paid were or were not properly divisible, has no bearing on Mr. Cory's liability, and I am very reluctant to give any opinion upon it, inasmuch as the question may arise when it may be necessary to decide it. I deprecate any premature judgment. My Lords, I am, as I have said, very reluctant to enter into a question which for the reasons I have given does not arise here, and into which the Court of Appeal has entered at some length. The only reason why I refer to it at all, is lest by silence I should be supposed to adopt a course of reasoning as to which I am not satisfied that it is correct. I doubt very much whether such questions can ever be treated in the abstract at all. The mode and manner in which a business is carried on, and what is usual or the reverse, may have a considerable influence in determining the question what may be treated as profits and what is capital. Even the distinction between fixed and floating capital, which in an abstract treatise like Adam Smith's ‘Wealth of Nations’ is appropriate enough, may with reference to a concrete case be quite inappropriate. It is easy to lay down as an abstract proposition that you must not pay dividends out of capital, but the application of that very plain proposition may raise questions of the utmost difficulty in their solution. . . . On the one hand, people put their money into a trading concern to give them an income, and the sudden stoppage of all dividends would bend down the value of their shares to zero, and possibly involve its ruin. On the other hand, Companies cannot at their will and without the precautions enforced by the statute reduce their capital; but what are profits and what is capital may be a difficult and sometimes an almost impossible problem to solve. When the time comes that these questions come before us in a concrete case we must deal with them, but until they do, I, for one, decline to

express an opinion not called for by the particular facts before us, and I am the more averse to doing so because I foresee that many matters will have to be considered by men of business which are not altogether familiar to a Court of Law

Davey, L. J., said: —

“I desire to express my dissent from some propositions of law which were laid down in the Court of Appeal and upon which your Lordships thought it right to hear the Respondents’ Counsel. The learned Judges seem to have thought that a Joint Stock Company, incorporated under the Companies Acts may write off to capital, losses incurred in previous years and may in any subsequent year, if the receipts for that year exceed the outgoings pay dividends out of such excess without making up the Capital Account. If this proposition be well founded it appears to me that a Company whose capital is not represented by available assets need never trouble itself to reduce its capital with the leave of the Court and subject to the other conditions imposed by the Act of 1877, in order to enable itself to pay dividends out of current receipts. My Lords it may be that I have misapprehended the statement of law intended to be made by the learned Judges in the Court of Appeal. I think that is possible, because I find that in *Terner v. General and Commercial Investment Trust* (1894, 2 Ch. 124), perhaps Lord Lindley says, the shortest way of expressing the distinction which I am endeavouring to explain is to say that fixed capital may be sunk or lost and yet that the excess of current receipts over current payments may be divided, but that floating or circulating capital must be kept up, as otherwise it will enter into and form part of such excess in which case to divide such excess without deducting the capital which forms part of it will be contrary to law. I reserve my opinion as to the effect of an actual and ascertained loss of part of the Company’s fixed capital. But, subject to this observation I think that the statement of law in the passage I have quoted is not open to objection, and it is only because the learned Judge appears to me to have departed from it in his judgment in the present case that I have troubled your Lordships with these remarks.”

(6) *Bond v. Barrow Hematite Steel Co., Ltd.* (1902, 1 Ch. 358).

Held that where the Articles give power to put to Reserve before the payment of a dividend, Preference Shareholders cannot compel Directors to declare a Dividend without making such Reserves as they consider necessary.

The Profit and Loss Account of this Company for the year 1900 showed a balance of £157,605 12s. 11d.,

which was provisionally carried forward. No depreciation had been written off the amounts at debit of land, buildings, works, fixed plant, and mining leases for some years, and on a revaluation being made it appeared that a considerable loss had been sustained, and application was made to the Court for reduction of Capital. This was dismissed on the ground that the alleged loss was not proved to the satisfaction of the Court, and an action was subsequently taken by certain Preference Shareholders to compel the Company to pay their Dividends out of the credit balance on Profit and Loss Account, without making good the loss stated to have been sustained.

Farwell, J., gave Judgment for the Company, on the ground that the Preference Shareholders could not compel Directors to declare a Dividend without making such Reserves as they considered necessary, but he added some further remarks on the question of the application of the *Lee v. Neuchatel* series of cases, which are of some importance.

He said:

"It has been proved to my satisfaction . . . that the Company has sustained an actual ascertained and realised loss of capital to an amount exceeding £200,000, and has also lost capital by estimate and valuation to an amount exceeding £50,000. The various sums claimed by the plaintiffs as available to pay their dividends amount to about £240,000. It, therefore, these ascertained and estimated losses have to be made good before any dividend can properly be paid, there are obviously no funds out of which to pay dividends. The defendants allege and the plaintiffs deny that the Company are bound to make good these losses before paying any dividend. The question is one of very considerable difficulty on the authorities, but the result of these authorities is, in my opinion, that there is no hard and fast rule by which the Court can determine what is capital and what is profit. . . . The real question for determination, therefore, is whether there are profits available for distribution, and this is to be answered according to the circumstances of each particular case the nature of the Company, and the evidence of competent witnesses. . . . Now in the present case the £200,000 realised loss arises by

the surrender of the leases of certain mines, by the pulling down of certain furnaces, and on the sale of certain cottages. The Company is a smelting Company on a very large scale, and for the convenience of its works and by way of economy they acquired the leases of the surrendered mines in order to supply themselves with their own ore instead of buying it as required. The ore was used exclusively for the purposes of the Company's works. The mines were drowned out and the cost of pumping them out was prohibitive. The Company, therefore, surrendered the leases, pulled down the blast furnaces, and sold the cottages connected therewith. Now the evidence before me is all on one side. The Plaintiffs called none, and Sir David Dale and the Defendants' other witnesses all agree that in a Company of this nature these items ought to come into the account before any profit can be said to be earned, and my own opinion coincides with theirs, inasmuch as I think that the money invested in those items is properly regarded in this Company as circulating capital. Suppose the Company had bought enormous stocks of ore sufficient to last for ten years, it could hardly be said that the true value of so much of this as remained from time to time ought not to be brought into the Balance Sheet, and I can see no difference for the purpose of the account between ore *in situ* and ore so bought in advance. The blast furnaces and cottages are mere accessories to the ore, and resemble a building for burning the stores bought in advance already mentioned. There is more difficulty about the remaining £50,000. I think that the onus is on the Plaintiff to show that it is fixed capital, and that in a Company of this nature such fixed capital may be sunk or lost. They have not done this, and the evidence, so far as it goes, is the other way. But this is not an actual loss, but depreciation by estimate. The Plaintiffs really relied on *Lee v. Neuchatel Asphalte Company* as an authority for this proposition as a universal negative--viz., 'that no Company owning wasting property need ever create a Depreciation Fund.' In my opinion that is not the true result of the decision. It must be remembered that in that case there had been no loss of assets. The Company's assets were larger than at its formation, and the Court decided nothing more than the particular proposition that some Companies with wasting assets need have no Depreciation Fund. For instance, I cannot think that it would be right for the Defendant Company to purchase out of capital the last two or three years of a valuable patent and distribute the whole of the receipts in respect thereof as profits, without replacing the capital expended in purchase. It is for the Court to determine in each case on evidence whether the particular Company ought, or ought not, to have such a fund. There is no doubt as to the opinion of the witnesses in this case, and further, the opinion of the Directors cannot be altogether disregarded. The Courts have, no doubt in many cases, overruled Directors who proposed to pay dividends, but I am not aware of any case in which the Court has compelled them to pay when they have expressed their opinion that the state of the accounts do not admit of any such payment. In a matter depending on evidence and expert opinion it would be a very strong measure for the Court to override the Directors in such a manner."

(7) *Ammonia Soda Co. v. Chamberlain*, 1918 (L.J. 87, Ch. 193).

Held that it is not necessarily illegal for Directors of a Company to pay dividends out of the profits of the Company during a current year without making good existing deficiencies in paid-up capital, or without writing off a debit to the Company's Profit and Loss Account, occasioned by losses in previous years.

The Profit and Loss Account of this Company in the year 1911 showed a debit balance of £19,028. This amount arose by debiting to that Account at a time when the Company's gross trading profit was insufficient to provide for the purpose certain sums for depreciation of buildings, plant and machinery, and also for Directors' fees and mortgage and debenture interest.

In 1908, a boring made by the Company to reach "water for use in the Company's works, failed in that purpose, but showed a new bed of rocksalt, of a thickness of about 666 feet, which was previously unknown. This discovery was considered to increase the value of the Company's property, and the Directors obtained a report from two of their number which advised that their land should be valued at the increased figure of £79,166, and its value was raised in the Balance Sheet of July, 31st 1911, from £63,246 to £83,788 by the addition of a sum of £20,542. This sum was credited to a Reserve Account and used to cancel £12,990 of the debit of £19,028 in the Profit and Loss Account, the remainder being written off out of net profits. For the thirteen months ending January 31, 1912, the net profit made by the Company was £13,030, and for the twelve months ending January 31, 1913, £15,669. From September, 1912, to April, 1915,

dividends amounting to £13,116 were paid on the preference shares of the Company. In so far as these dividends were paid before providing for the £12,990, the proportion of the debit balance on the Profit and Loss Account referred to above, it was claimed that they were paid out of capital and that the Directors were liable to repay the same. The Court of Appeal held that the revaluation of the property was *bonâ fide* and that the Directors were not liable to refund any of the dividends. The facts were not, in any way, concealed from the Shareholders and the treatment adopted had been clearly drawn to their attention by the Auditors in their report.

In the course of his judgment, Swinfen Eady, L.J., said :—

“ The plaintiffs contend that, although net profits were earned during the period they were not available for dividend, and cannot really be considered ‘ profits,’ as in the earlier period of the Company’s history, a loss had been incurred, and they contend that until such loss has been first made good there cannot be any profits in the real true sense of the word. In my judgment, this argument is unsound and has been exposed again and again. The Companies Acts do not impose any obligation upon a limited company, nor does the law require it, that it shall not distribute as dividend the clear net profit of its trading unless its paid-up capital is intact, or until it has made good all losses incurred in previous years Counsel for the appellants invited the Court to lay down that wherever there was a debit to the Profit and Loss Account, irrespective of the way in which it arose, of the stage in the Company’s operations, and of the nature and business of the Company, it was illegal to divide profits subsequently earned without first writing off out of those profits the amount of the debit. To do so would be to fall into the error which Lord Macnaghten pointed out should be avoided, and would only serve to harass and embarrass business men, and impose upon companies a burden which Parliament has abstained from casting upon them. The Directors in this case were of opinion that no capital had been really lost, and they were of opinion that the value of the land and works as a going concern had been increased, as a result of their boring and exploratory work, to a considerably greater amount than £19,028. . . . The result of increasing the value at which the land stood was to give a credit which would have enabled the debit of £19,028 to be written off. Part of it was, however, actually written off out of subsequent net profits. Now, the debit consisted in part of a nominal depreciation in the fixed assets

of the Company, buildings, plant and machinery, and as regards the balance, it consisted of sums paid out of the subscribed capital of the Company for mortgage and debenture interest, and Directors' fees, there not being sufficient trading profits to provide these amounts. The transaction was carried out with the full approval of the Shareholders in General Meeting, and in all honesty and good faith. The dividends complained of, paid out of net earnings in the subsequent years, were not paid out of capital, but out of profits, and the defendants are, in my opinion, under no liability whatever to repay the same, or any part. . . . "

Warrington, L.J., said : -

"There is, however, one accepted restriction on the powers of companies incorporated under the Companies Acts, namely, that they must not, under the guise of dividends or in any other way, return to their Shareholders money subscribed for their shares, unless it be with the sanction of the Court under the appropriate statutory provisions. It has been asserted in this case, not for the first time, that there is a further restriction - suggested to be a corollary of the rule I have just mentioned - which would make it illegal for a company to pay dividends out of the profits of a current year, unless it first makes good deficiencies in paid-up capital occasioned by losses in previous years; or, to put the contention in a broader form, no dividends can properly be paid out of profits so long as there are losses previously incurred and not made good. In my opinion this alleged restriction has no foundation in law. . . . I am, of course, far from saying that in all such cases dividends can properly be paid without making good the previous loss; the nature of the business and the amount of the loss may be such that no honest and reasonable man of business would think of paying dividends without providing for it. In such a case, I apprehend the Court would take the view that a payment which no honest and reasonable man of business would think it right to make could not properly be made by Directors."

(b) Legal Decisions considered.

The authority of the Judgments of the Court of Appeal in the *Lee v. Neuchatel* series of decisions was regarded as somewhat shaken by the remarks of Lord Halsbury and Lord Davey in the House of Lords Appeal in *Dovey v. Cory*, quoted above; and the remarks of Farwell, J., in the *Bond v. Barrow Hæmatite* case further indicate that these decisions must be taken as applying to the specific cases concerned, and that in future each case must be taken in connection with the particular circumstances surrounding it.

In the case of *Ammonia Soda Co. v. Chamberlain*, the Court of Appeal strongly confirmed the principles laid down by its predecessors in the *Lee v. Neuchatel* series of cases, and clearly indicated that if these were to be disturbed, it must be done by some higher Court than the Court of Appeal.

Accordingly it becomes a matter of some difficulty to attempt to summarise the legal position as regards the necessity of providing Depreciation in respect of Fixed or Wasting Assets.

Before considering as to how far it is wise to rely upon the authority of the judgments in actual practice, it is desirable to note the financial distinction between the result of the Judgment in the *Neuchatel* case, and that in the *Verner* case. The latter followed the former from a legal point of view, but the financial position of a Trust Company is fundamentally different from that of a Mining Company, although the Court took no cognisance of this distinction.

In the *Neuchatel* case the principal property of the Company consisted of a leasehold Mine, which was gradually exhausted in the process of earning income. The Capital contributed by the Shareholders was sunk in acquiring this particular property, and the question was whether it was necessary to make good the waste before distributing a Dividend out of the excess of current income over current expenditure. The Articles of the Company gave power to distribute Dividends without so making good, and from the Judgment of the Court, and subsequent decisions, it is clear that this Article was not regarded as *ultra vires* the Companies Acts. The contention, therefore, that any Company in similar circumstances, desiring to act in this manner must first have power under its Articles

to do so falls to the ground, since had the Neuchatel Company's Article been *ultra vires* it could have afforded no authority to the Company to distribute Dividends without providing for the Depreciation.

In the case of a Company formed for the express purpose of working a leasehold mine, it is probable that the Shareholders of the Company would expect it to go into liquidation on the exhaustion of its principal asset. If this were so, assuming that the Development Account were properly treated, and a sufficient balance of working capital maintained, the moneys retained out of profits representing any further provision for Depreciation could not be utilised by the Company, but would necessarily have to be invested in outside securities. These investments would gradually accumulate, and if the calculations on which the Depreciation was based were correct, on the final exhaustion of the asset the Company would be in possession of funds sufficient to pay back in full to the Shareholders the nominal value of Capital contributed by them. Though this may be considered as theoretically desirable, Shareholders might not necessarily desire this course to be taken, but might prefer to receive larger dividends during the life of the mine. In a case of this sort, where the Company is expected to wind up on the exhaustion of its principal asset, the matter becomes one of policy, and there would seem to be no reason, financial or otherwise, why the general body of Shareholders should not receive the bulk of their proportion of Capital by way of dividends, should they desire to do so.

The *Verner* case, however, although it was decided on the precedent of the *Neuchatel* case, presents a totally different aspect from the practical point of view.

The Company was a Trust Company, and the investments had very largely depreciated. Although the Court held that the investments of a Trust Company are to be regarded as Fixed Assets, they cannot be called Wasting Assets, and therefore are not in the same category as a leasehold mine or a cemetery.

The Shareholders of a Trust Company do not anticipate that the securities in which the bulk of their Capital has been invested are assets of a wasting nature. The Company is not expected to wind up within any definable period ; and no doubt the majority of the Shareholders would expect their Capital to be returned to them in full on liquidation. On the other hand, shareholders in companies of this nature, rely upon obtaining regular income, and to be deprived of dividends for a long period while capital loss is made good, would prove a tremendous hardship in many cases. The experience of the war has shown that in practice this is not regarded as necessary, and all the Trust Companies have continued to pay somewhat reduced dividends, without making good the great depreciation in their securities occasioned by the war.

This case, therefore, cannot be regarded as similar to the *Neuchatel* case from a financial point of view, notwithstanding the fact that the Court treated the question of Depreciation in the same manner. Lindley, L. J., said that although a proceeding might be perfectly legal, it might be opposed to sound commercial principles, but that the Court had only to consider the legality or illegality of the Company's action.

The same Judge made some important remarks on the distinction between "Fixed" and "Floating" assets, when he said that "Fixed" Capital might be

sunk and lost, and yet the excess of current receipts over current payments might be divided, but that "Floating" or "Circulating" Capital must be kept up, as otherwise it will enter into and form part of such excess, in which case, to divide such excess without deducting the Capital which forms part of it, will be contrary to Law.

The terms "Fixed" and "Floating" or "Circulating" Capital here used are equivalent to that portion of the Capital represented by "Fixed" or "Floating" Assets.

From the remarks of Lindley, L. J., in both the *Neuchatel* and *Verner* cases it is clear that the Court will protect the interests of creditors and that even in a case where it may not be necessary to make good depreciation on wasting assets before paying a dividend sufficient assets must be retained to pay the company's debts and liabilities.

In *Wilmer v. McNamara & Co., Ltd.* (*supra*) the Court followed the *Neuchatel* case, Stirling, J., stating that Depreciation of goodwill and leaseholds was in his opinion to be treated as a loss of "Fixed" Capital, and accordingly it was not obligatory on the Company to provide for such loss out of revenue before paying any dividend. Some doubt, however, was expressed by him with reference to the adequacy of the provision made for the Depreciation of the leaseholds, and it would seem prudent to regard such provision as necessary in ordinary cases.

As already indicated doubt has been thrown upon this series of decisions by the remarks of the Law Lords in *Dovey v. Cory* (*supra*). The Court of Appeal in the *National Bank of Wales* case had implied by their judgment that the payment of dividends without

making provision for bad debts was not equivalent to paying dividends out of Capital, and although the House of Lords was not required to express an opinion on this point, the Lord Chancellor stated the only reason why he referred to it at all was lest by silence he should be supposed to adopt a course of reasoning as to which he was not satisfied that it was correct. He doubted whether such a question could ever be treated in the abstract at all, and expressed his opinion that distinction between "Fixed" and "Floating" Capital might be appropriate enough in an abstract treatise but might be quite inappropriate with reference to a concrete case. His remarks clearly indicate that the House of Lords held their opinion on these matters in suspense, and did not desire it to be thought that they necessarily upheld the opinions expressed by the Court of Appeal in the *Lee v. Neuchatel* series of cases.

In the same case Davey, L. J., expressed his dissent still more strongly from the propositions laid down in the Court of Appeal.

In *Ammonia Soda Co. v. Chamberlain* (*supra*), the Court of Appeal took the view that it was not in all cases necessary to make good a debit balance on the Profit and Loss Account before paying dividends out of current profits, but regard must be had to the way in which such debit balance has been arrived at, the stage of the Company's operations, and to all the facts of the case. The payment of dividends out of current profits without making good prior losses is not necessarily the payment of dividends out of capital. It is clear, however, that each case must still be considered on its merits, and it is very difficult to lay down any fixed rule.

In *Bond v. Barrow Haematite Steel Company (supra)*, the Company had sustained an actual ascertained and realised loss exceeding £200,000, and a further estimated loss exceeding £50,000. Had these losses been written off no dividend could have been paid.

Farwell, J., said that the question was one of very considerable difficulty on the authorities, but in his opinion the result of these authorities was that there was no hard-and-fast rule by which the Court could determine what is Capital and what is Profit. The loss in this case arose in connection with certain assets which had been acquired in order to enable the Company to produce its own ore instead of purchasing ore in the market, and the Court held that such expenditure was equivalent to expenditure on large stocks of ore bought in advance, and as such, any loss arising thereon should be treated as a loss of Circulating Capital, which ought to be made good before paying a Dividend. It is apparent, therefore, that the classification of Assets in any particular case as between "Fixed" and "Floating" is a question of fact which will be decided by the Court, having regard to all the circumstances, and to the opinions of experts and business men, and further that the Courts are strongly disinclined to lay down any general rule on the subject.

As regards the question of Depreciation on fixed Assets similar remarks apply.

Farwell, J., said in the case quoted above, that the *Neuchatel* case was no authority for the proposition that no Company owning "wasting" property need ever create a Depreciation Fund. In his opinion the Court decided nothing more than that some Companies with "Wasting" Assets need have no Depreciation Fund. It was for the Court to determine in each case

on evidence whether the particular Company ought or ought not to have such a fund.

In this connection the decision of the Scotch Courts in *Cox v. Edinburgh & District Tramways Co.* ("Glasgow Herald," 17 June, 1898) may be noted. The Company had incurred a heavy loss in converting their system from horse to mechanical traction, and the Court held that such loss need not be made good before the payment of a Dividend, on the ground that it might be assumed that the additional expenditure enhanced the value of the undertaking as a whole.

The legal position as regards Depreciation may therefore be summarised as follows: —

- (1) Depreciation on "Floating" Assets must be made good before the payment of a Dividend. (*Verner v. General and Commercial Investment Trust, Ltd.*; *Bond v. Barrow Hæmatite Steel Co.*)
- (2) Depreciation on "Fixed" or "Wasting" Assets need not necessarily be made good before the payment of a Dividend, though sufficient assets must be retained to pay liabilities (*Lee v. Neuchatel Asphalte Co., Ltd.*; *Bolton v. The Natal Land Co.*; *Verner v. General and Commercial Investment Trust*; *Wilmer v. McNamara & Co.*); but as to whether such provision is necessary or not is a question of fact to be determined by the Court, having regard to the circumstances of each particular case and the Memorandum and Articles of the Company concerned. (*Dovey v. Cory*; *Bond v. Barrow Hæmatite Steel Company.*)

The Auditor should therefore consider each case in practice according to the circumstances, and where

loss of fixed assets has not been written off he should report the fact to the Shareholders. Where, by not making such provision, the financial position of the Company is likely to be seriously affected, and its creditors prejudiced, he should draw the attention of the Directors and the Shareholders to this point of view, and recommend that the necessary provision should be made. Where the omission to provide Depreciation will only ultimately affect the Shareholders when the Company is wound up, the matter is more of a domestic nature for the Shareholders themselves to decide, and as long as the Auditor places them in possession of the facts, he will have absolved himself from any responsibility in connection with the matter.

§ 3.—Capital Profits.

The question as to whether Capital Profits are available for the payment of Dividends, and if so, under what circumstances, is a particularly important one, and there have been two cases decided which will now be summarised, and from which it will be possible to draw some general conclusions.

(a) Legal Decisions.

- (1) *Lubbock v. The British Bank of South America* (1892, 2 Ch. 198).

Held that a profit made on the sale of a part of the undertaking of a Company is available for Dividend, if the Articles so permit.

This Company, under the name of the English Bank of Rio de Janeiro, had sold to another bank its goodwill and property in Brazil for a sum of £875,000, agreeing, upon the payment of that sum, to discontinue the

use of its name, and to adopt a name not indicating a bank doing business in Brazil, and also contracting to refrain from carrying on business in Brazil. Subsequently this restraint was released on payment by the defendant bank of £75,000; and the £205,000 which it was proposed to distribute consisted of the original consideration for the Brazilian business, less the paid-up Capital of the Company (£500,000), together with the £75,000 referred to above, and sundry other payments, for outgoings and compensations in reference to the sale of the Brazilian Bank.

Chitty, J., held that the £205,000 was plainly profit on Capital, and not part of the Capital itself, for that sum was the surplus ascertained after the liabilities and Capital were placed on one side of the account and the assets on the other. Under the Articles of the Company the Directors were justified in carrying over the £205,000 to a Profit and Loss Account; and having appropriated to the Reserve Fund so much of the sum as they thought fit, they could distribute the remainder as Dividends after an ordinary Meeting, called in pursuance of the Articles, had passed the requisite resolution.

(2) *Foster v. The New Trinidad Lake Asphalt Company, Ltd.* (1901, 1 Ch. 208).

Held that a realised appreciation in the value of a book debt taken over by a Company at its formation is not profit available for Dividend, unless such surplus remains after a revaluation of the whole of the assets.

This Company at its formation had taken over amongst other assets a debt of \$100,000, secured by Promissory Notes. This debt was not then regarded as of any value, but subsequently it was paid in full,

together with interest accrued, realising £26,258 16s. As no value was placed on this asset in the Company's books, the amount received was treated as a profit, and it was proposed by the Directors to regard the same as available for Dividend, and to distribute it accordingly, without taking into account any decrease in the value of other assets.

Byrne, J., in the course of his Judgment restraining the distribution, said :—

“ It appears to me that the amount in question is *prima facie* capital, and that I have no evidence which would justify me in saying that it has changed its character because it has turned out to be of greater value than had been expected. . . . I must not, however, be understood as determining that this sum or a portion of it may not properly be brought into Profit and Loss Account or be taken into account in ascertaining the amount available for dividend. That appears to me to depend upon the result of the whole account for the year. It is clear I think, that an appreciation in total value of capital assets, if duly realised by sale or getting in of some portion of such assets, may in a proper case be treated as available for purposes of dividend. This, I think, is involved in the decision in the case of *Lubbock v. British Bank of South America* (1892, 2 Ch. 198), cited with approval by Lord Lindley in *Verner v. General and Commercial Investment Trust* (1894, 2 Ch. 239, at page 265), where he says :— ‘ Moreover, when it is said and said truly, that dividends are not to be paid out of capital the word ‘ capital ’ means the money subscribed pursuant to the Memorandum of Association, or what is represented by that money. Accretions to that capital may be realised and turned into money, which may be divided amongst the Shareholders, as was decided in *Lubbock v. British Bank of South America*.’ If I rightly appreciate the true effect of the decisions, the question of what is profit available for dividend depends upon the result of the whole accounts fairly taken for the year, capital, as well as profit and loss, and although dividends may be paid out of earned profits, in proper cases, although there has been a depreciation of capital, I do not think that a realised accretion to the estimated value of one item of the capital assets can be deemed to be profit divisible amongst the Shareholders without reference to the result of the whole accounts fairly taken.”

(b) Legal Decisions considered.

From a consideration of the above cases taken in conjunction with one another, it may be said that Capital Profits are not available for dividend unless :

- (1) The Articles of Association permit such distribution ;
- (2) The surplus is realised ; and
- (3) Such surplus remains after a proper valuation of the whole of the assets has been fairly taken.

In the *New Trinidad* case the Company was not apparently prepared to revalue the whole of their assets ; had they been willing to do so, and had they been able to prove to the satisfaction of the Court that a Capital Profit was finally shown, there is no doubt but that the Court would have permitted such profit to be distributed in dividend.

Where expenditure of a Capital nature has been charged to Revenue, a Company can subsequently recoup the Revenue Account out of Capital ; and the same procedure can be followed where an estimated loss on Capital Account has been charged to Revenue, but the assets have subsequently appreciated. (*Mills v. Northern Rly. of Buenos Ayres Co.*, 1870, 5 Ch. 621 ; *Bishop v. Smyrna and Cassaba Rly. Co.* (No. 2), 1895, 2 Ch. 596.)

Capital profit arising on a *bona fide* revaluation of fixed assets can be utilised to write off a debit balance on the Profit and Loss Account arising in prior periods, thus enabling dividends to be paid out of current profits. (*Ammonia Soda Co. v. Chamberlain*, 1918, L.J. 87, (Ch. 193.)

§ 4.—Divisible Profits.

Having regard to the fact that the legal decisions which have been given on the question of Divisible Profits depend to a very large extent on the circumstances of each particular case, it is somewhat hazar-

dous to attempt to lay down in general terms any definition of Divisible Profits. From the Auditor's point of view, however, it is desirable that some general rule should be formulated. Subject therefore to the qualifications above-mentioned and to the Memorandum and Articles of the Company concerned, the Divisible Profits of a Company may be said to be :—

- (1) The excess of current Income over current Expenditure after making good depreciation on floating assets and retaining sufficient funds to pay liabilities, but without necessarily in all cases taking into account depreciation on fixed assets.
- (2) Capital Profits may be divisible if they are realised and a surplus remains after making good any Capital losses, and if it is within the powers of the Company to distribute such Capital Profits.
- (3) Revenue losses must be made good before Profits can be distributed, and Capital losses must be made good before Capital Profits can be distributed ; but Capital losses need not necessarily be made good before Revenue Profits are distributed.

It is not, however, necessarily illegal for dividends to be paid out of current profits without making good existing deficiencies in paid-up capital, or without writing off a debit on the Company's Profit and Loss Account occasioned by loss in previous years.

§ 5.—Dividends.

The Divisible Profits of a Company having been considered, there remain a number of points which

require to be dealt with in connection with the declaration and payment of Dividends.

(a) Interim Dividends.

Under clause 96 of Table "A," the Directors may from time to time pay to the Members such Interim Dividends as appear to the Directors to be justified by the profits of the Company and where this Table applies, or the operation of this clause is not excluded, the Directors will have this power. Under the original Table "A," no power is given to pay Interim Dividends, and Companies continuing to work thereunder cannot, therefore, pay such Dividends except a resolution be passed at an Extraordinary General Meeting for that purpose. Most Companies having Articles of their own, are empowered to pay Interim Dividends.

The question as to whether a Company is justified in paying an Interim Dividend, and, if so, to what extent, is a most important one, and the advice of the Auditor is frequently asked for. In such circumstances, he should suggest that Interim Accounts be prepared for the purpose of ascertaining what profits have been made. Many Companies have half-yearly accounts prepared for this reason. Assuming such Accounts have been prepared, and a profit is shown after making all the necessary adjustments and proper Reserves for Depreciation, Bad Debts, &c., the question will arise as to what proportion of such profit can be applied in payment of an Interim Dividend. Certain considerations must be taken into account before the decision as to the rate of Dividend to be paid can be arrived at. Where the Dividend is in respect of Preference Shares, the Dividends on which are expressed to be payable half-yearly, and there is ample margin, of

profit, the full half-yearly Dividend may be paid ; but in the case of Ordinary Shares, it is advisable that the Interim Dividend should be declared at a considerably lower rate than the estimated Dividend for the whole year. The payment of an Interim Dividend at a higher rate than the final Dividend is not usual in commercial practice, and the declaration of the final Dividend at a lower rate than the Interim Dividend generally results in a reduction in the market value of the Company's Shares.

It must be remembered that an Interim Dividend is only a payment on account of the whole Dividend for the year and, consequently, if an Interim Dividend is declared in respect of profits earned during a portion of the year, and during the remainder of the year a loss is made, resulting in a loss on the whole year, the Interim Dividend will have been paid out of Capital.

The general conditions and prospects of the trade carried on by the Company must, therefore, be taken into account in this connection. The financial aspect of the matter also requires consideration. If the liquid position of the Company is not strong, and the whole of the funds in hand are required for carrying on the business, it is not advisable to reduce the resources by distributing an Interim Dividend, but this general principle may be subject to special considerations which will be referred to subsequently.

In the case of a Company carrying on business of a regular and stable nature, where the rate of gross profit earned is subject to little, if any, variation, it may be possible to arrive at a sufficiently accurate estimate of the profits without taking stock or preparing completed accounts. The gross profit for the period

can be estimated by calculating the average percentage of gross profit on the turnover earned in previous years ; and the actual expenses incurred by the Company can be ascertained from the Impersonal Ledger. After all the necessary allowances have been made for outstandings, reserves, &c., the net profit can be estimated with sufficient accuracy, although in such cases more margin should be allowed in fixing the rate of Dividend than when actual accounts have been prepared.

It is sometimes thought by persons unacquainted with the fundamental principles of account, that if there is a considerable Cash balance, this fact is in itself sufficient to justify the payment of an Interim Dividend, and that the preparation of a Receipts and Payments Account is an adequate substitute for an Interim Profit and Loss Account. This idea is entirely fallacious, and, if acted upon, might easily result in the Dividend being paid out of Capital.

The Receipts and Payments Account might include receipts on account of Capital or Loans, the proceeds of which have not yet been expended, with the result that a large balance remains in hand ; or, on the other hand, considerable Capital payments might have been made with the result that the balance in hand might be less, rather than more, than the actual Profit earned.

No account is taken of fluctuation in the amounts of stock, debtors or creditors. Stock and debtors might be materially less than at the commencement of the period, and, consequently, the Cash balance might be increased, or the creditors might be greater, with a similar result ; in neither case might any profit have been earned. No account is taken of the Reserves necessary for bad debts, depreciation, or other losses which may not have arisen through cash transactions.

Consequently, it is quite conceivable that there might be a large Cash balance, when, as a matter of fact, a loss has been sustained, or a small Cash balance, when a considerable Profit has been earned; and, therefore, no reliance can be placed upon a Receipts and Payments Account, for the purpose of determining whether or not an Interim Dividend should be paid.

Where a Bonus was improperly declared on the faith of a surplus shown by a Receipts and Payments Account, without the preparation of a Profit and Loss Account and Balance Sheet, and without making due allowance for Outstandings, the Court ordered a Director who had participated in the Bonus to refund the amount received by him. (*Rance's Case*, 1871, L.R. 6 Ch. 104.)

(b) Final Dividends.

The Articles usually give power for the Directors to declare and pay Final Dividends on Preference Shares, but not on Ordinary Shares, a resolution of the Shareholders in General Meeting being required to authorise the latter.

In no case should a Final Dividend be declared until the Accounts of the year have been prepared and the actual divisible profits ascertained. The considerations which will guide the Directors in recommending to the Shareholders the amount of the Final Dividend are similar to those discussed above; and it has already been pointed out that in most cases no Dividends can be declared unless previously recommended by the Directors, and that they usually have absolute discretion as to the amount they consider it advisable should be distributed, having regard to the actual profits earned by the Company, and to their

power (if any) to place to Reserve any amount they may think necessary before recommending the payment of a Dividend. In *Bond v. Barrow Haematite Steel Co.* (1902, 1 Ch. 358), Farwell, J., said that the Court would be very reluctant to compel Directors to divide more than they thought proper; and the Court will not compel a division of profits up to the hilt, but regards it as perfectly proper and lawful for a Company to carry forward a portion of the year's profits to the credit of next year's Profit and Loss Account. (*Burland v. Earle*, 1902, A.C. 95.)

When once a Dividend has been declared and becomes payable it is a debt, and each Shareholder is entitled to sue the Company for his proportion (*Severn & Wye Railway Co.*, 1896, 1 Ch. 559); but until the Dividend has actually been declared, the right to sue does not arise. (*Bond v. Barrow Haematite Steel Co.*, 1902, 1 Ch. 358.)

Dividends declared but not paid at the date of the Balance Sheet must, therefore, appear as liabilities.

The declaration of an Interim Dividend, however, will not of itself necessarily create a debt, and the Resolution may be rescinded. (*Lagunas Nitrate Co. v. Schrøder*, 1901, 85 L.T. 22.)

Clause 98 of the present Table "A" provides that subject to the rights of persons, if any, entitled to Shares with special rights as to Dividends, all Dividends shall be declared and paid according to the amounts paid on the Shares. Previously, unless the Articles provided otherwise, Dividends were payable in proportion to the nominal amount of the Shares, irrespective of whether some Shares were fully paid up and others only partly paid up (*Oak Bank Oil Co. v. Crum*, 1883, 8 A.C. 65; *Bridgewater Navigation Co.*,

1891, 14 A.C. 525). This principle was adopted by the original Table "A," but was not generally regarded as equitable, and is not followed in the present Table.

(c) **Preference Dividends.**

The rights of Preference Shareholders to Dividends will be defined in the Articles, and the question as to whether such Shareholders are entitled to Simple or Cumulative Dividends in the absence of express provisions has been considered in Chapter IX., § 2.

Where the Dividends on the Preference Shares depend on the profits of each particular year only, the Preference Shareholders are entitled to their Dividend out of the profits of any year after providing a proper amount for depreciation, maintenance, and renewals for that year, and must not be deprived of their dividend for the purpose of enabling the Company to make good amounts which in previous years should have been provided for maintenance, but which have been improperly applied in payment of Dividends. (*Dent v. London Tramways Co.*, 1881, 16 Ch. 344.)

A Company may not manipulate its accounts for the benefit of any particular class of Shareholders, but Preference Shareholders are not entitled to prevent the Company from applying the current profits of any year to making good losses incurred in previous years, or from making such reserves as the Directors think necessary under powers conferred on them by the Articles (*Bond v. Barrow Hæmatite Steel Co.*, 1902, 1 Ch. 358).

A recent case, which is closely analogous to the above, further illustrates this point:—

A Railway Company had issued certain Debentures, the interest on which was payable only out of the net

earnings of the Company after payment of all working and administration expenses, and such interest was payable only so far as such net earnings, after the payment of such expenses, should extend.

For the year in question, the Company made a profit, after payment of interest on prior lien debenture stock, of £19,247, which, added to the sum of £22,250 brought forward from the preceding year, left a balance of £41,497, of which it was proposed to place £10,000 to Reserve, and to carry forward the balance of £31,497, without paying any interest to the Debenture Holders above referred to.

Eve, J., *held* that the amount of £10,000 placed to Reserve should be treated as drawn proportionately from the current profits and from the previous year's balance carried forward. This treatment would reduce the current year's profit to about £14,000, and on this he made an order declaring that the Company was entitled to set aside so much as in the opinion of the Directors was required for the maintenance of the security, and that the balance ought to be distributed amongst the Debenture Stockholders (*Heslop v. Paraguay Central Railway Company, Ltd.*, 1910, 54 S.J. 234).

(d) Arrears of Cumulative Preference Dividends.

Where the Articles of a Company provide that no Dividend shall be paid until recommended by the Directors, and the Directors have power to put to Reserve before payment of any Dividend, arrears of Cumulative Preference Dividend do not become a liability until a resolution has been passed by the Directors to pay the same. The liability in respect of

such arrears not only depends on the fact of the Company earning profits, but also on the Resolution of the Directors to pay the arrears, which is optional on their part. The fact that the liability is contingent upon an act which the Directors may or may not perform at their discretion has the effect of preventing such arrears being regarded as a contingent liability at all, since that phrase implies a liability which will accrue on the happening of some event not within the control of the Company or the Directors. This view is supported by the case of *Crichtons Oil Co.* (1901, 2 Ch. 184, 1902 2 Ch. 86); where the rights of the Preference Shareholders did not arise until a Dividend had been declared, and the Directors had omitted to declare a Dividend before the Company went into Liquidation, although there were profits which would have been available for the payment of such Dividend, with the result that it was held that the Preference Shareholders were not entitled to their arrears of Dividend, the whole of the surplus in that case going to the Ordinary Shareholders.

If, however, the declaration of the Preference Dividend is not within the discretion of the Directors, but automatically becomes payable as soon as sufficient profits are earned, any arrears of Cumulative Preference Dividend would be a contingent liability and should be noted as such on the face of the Balance Sheet; but a provision of this sort is very uncommon, most Articles providing that no Dividend shall be payable until it has been recommended by the Directors.

* Although, therefore, such arrears are, in most cases, not a contingent liability, the Balance Sheet being the Balance Sheet of the Company as a whole, and not as affecting any particular class of Shareholders,

it is advisable to note on the face of the Balance Sheet the amount of the arrears for the information of all classes of Shareholders.

(e) Dividends paid out of Capital.

Dividends must only be paid out of Profits and cannot be paid out of Capital, and if the Memorandum or Articles of Association give power to the Company to do so, such power is invalid. (*Verner v. General & Commercial Investment Trust, Ltd.*, 1894, 2 Ch. 264; *re Sharpe*, 1892, 1 Ch. 154.)

Directors who knowingly pay Dividends out of Capital are personally liable to make good the amount of such Dividends to the Company (*Oxford Benefit Building Society*, 1887, 35 Ch. D. 502; *re London & General Bank*, 1895, 2 Ch. 673; *re Kingston Cotton Mill Company*, No. 2, 1896, 1 Ch. 331); but where such payment has been made on the faith of a *bonâ fide* valuation of a Company's assets, which subsequently proved to be an over-estimate, the Directors were not liable (*Stringer's Case*, 1869, 4 Ch. 475; *Rance's Case*, 1871, 6 Ch. 104); although if the Articles state that Dividends are only payable out of realised profits, the Directors may be responsible for a Dividend paid out of estimated profits. (*Oxford Benefit Building Society*, 1887, 35 Ch. D. 502.)

Directors are entitled to rely upon Reports and Valuations of trusted Officers of a Company, unless there is reasonable ground for suspicion. (*Re Kingston Cotton Mill Co.*, No. 2, 1896, 2 Ch. 288; *Dovey v. Cory*, 1901, A.C. 477.)

• If Dividends are received by Shareholders, knowing that they are paid out of Capital, the Directors may have a right of indemnity against such Members to

the extent to which they have respectively received Dividends, although they have not such right of indemnity if they represent that the Dividend is paid out of profits (*Moxham v. Grant*, 1900, 1 Q.B. 88); but the Directors will primarily be liable to the Company (*Re Alexandra Palace Co.*, 1883, 2 Ch. D. 149; *National Funds Assurance Co.*, 1879, 10 Ch. D. 118). Where an Interim Dividend has been paid out of Capital owing to a *bonâ fide* mistake, and the Directors propose to recoup such Dividend out of profits before distributing any further Dividends, a Shareholder who has received such Dividend cannot maintain an action against the Directors (*Towers v. African Tug Co.*, 1904, 1 Ch. 158); and when Dividends improperly paid out of Capital have been made good out of subsequent profits, liability ceases to attach to the Directors. (*Boaler v. The Watchmakers' Alliance, and others*, 1903, Acct. L.R. 23.)

The liability of the Auditor in connection with the payment of Dividends out of Capital is fully dealt with in Chapter XII.

(f) Scrip Dividends.

Power is sometimes taken to pay Dividends in kind, i.e. by the distribution of specific assets, but unless there is such power, Dividends must be paid in cash. (*Wood v. Odessa Water Works Co.*, 1889, 42 Ch. D. 645; *Hoole v. Great Western Railway Company*, 1868, 3 Ch. 262.)

Power is frequently taken by Finance Companies and others, to pay Dividends by the distribution of Shares or Debentures in other Companies, and such a distribution is known as a Scrip Dividend. The Shares, &c., should be distributed to the Members of the

Company in the same proportion as they are entitled to cash Dividends. The distribution must be made free of Income Tax, and it is important that provision for Income Tax payable should be made before the Dividend is distributed.

The process of capitalising Reserves by the distribution of a Dividend or Bonus, to be satisfied by the issue of fully-paid Shares, or to be applied in reduction of uncalled liability on Shares already issued, has been dealt with in Chapter IX., § 11.

(g) Vouching Dividends.

The Auditor should vouch the payment of Dividends by examining the returned Dividend Warrants. Usually a separate Dividend Pass Book is utilised, and where this is the case the checking of the Dividend will be materially facilitated. It should be seen that the total Dividend paid agrees with the total of the Shares issued as shown by the balances extracted from the Share Ledger. Where the Dividend is paid less Income Tax, it should be seen that the proper amount and rate of tax has been deducted. Where the rate of tax has been altered during the period covered by the Dividend paid, the rate of tax deducted should be *pro rata*, e.g. in respect of the Dividend payable for the year ending September 30th, tax being altered from 5s. to 6s. on April the 5th, the rate of tax deducted should be 5s. 6d.

Where Scrip Dividends are issued a Schedule should be submitted to the Auditor, showing the Shares allotted or transferred to each Shareholder, which he should check with the receipts obtained from the Shareholders. Where no such receipts have been obtained reference should be made to the Secretary

of the Company whose Shares have been distributed for verification of the Schedule.

(h) Unclaimed Dividends.

Power was given under the original Table "A" to forfeit unclaimed Dividends after the expiration of three years, but this was objected to by the Stock Exchange, and the power is not contained in the present Table. Dividends are frequently unclaimed, and where this is so, the amount thereof should be carried forward as a liability. If a separate Banking Account is utilised for the payment of Dividends, the unclaimed Dividends will appear as a balance upon this account as against the corresponding liability.

(i) Provision of Moneys for the Payment of Dividends. .

Although substantial profits may have been made and Dividends may be properly payable, the cash position of the Company may make the payment of the Dividend a matter of some difficulty. Such a situation may arise owing to a variety of causes. The Company's profits may be locked up in Book Debts or Stock, which will be realised in due course, but which have not been realised at the date when it is usual to pay the Dividend. In such a case it is usual for an overdraft at the Bank to be arranged for the purpose of paying the Dividend, the same being paid off as moneys become available.

Where, owing to the extension of the Company's business, the profits have been utilised as additional Working Capital, which will be required permanently, it is not desirable to pay a Dividend by temporary borrowing, as the necessity of continually renewing the loan will arise, and it is preferable, either that

the borrowing should be of a more permanent nature, taking the form of an issue of Debentures, or that fresh Capital should be issued. In either case the proceeds of the loan or of the issue of Shares can be utilised to pay the Dividend.

In other cases the shortage of cash may be due to the fact that the Company has incurred Capital expenditure which has been made out of realised profits. In this case also temporary borrowing is of no advantage, and the money should be obtained in one of the manners above mentioned.

An alternative method would be to capitalise the profits by the distribution of a Dividend to be satisfied by the issue of fully-paid Shares as previously described, or to be applied in reduction of uncalled liability on Shares already issued.

From the Auditor's point of view no exception can be taken to any of the above methods where the circumstances justify such a course, and the Auditor is satisfied that the profits have been actually earned. At the same time, except where the shortage is manifestly due to Capital expenditure having been made out of Revenue, the fact that profits do not appear to be realised should place the Auditor upon his guard, and cause him to enquire very carefully into the position. It is apparent that such a situation would be brought about by an improper inflation of Stock values, by the omission to make necessary Reserves for Depreciation, Bad Debts, &c., or by the omission to bring into account outstanding liabilities.

If the Auditor has satisfied himself that none of these factors have operated to bring about the reduction in the Cash position, and that the profits are genuine, no exception need be taken to the adoption of any of

the methods described above for the purpose of raising funds for the payment of Dividends.

(J) Reserves for the Equalisation of Dividends.

Where the profits of a Company fluctuate considerably from year to year, it is sometimes found desirable to institute a Reserve for the Equalisation of Dividends, profits being transferred to the credit of this account in good years, and being withdrawn subsequently when the current year's profits are insufficient to pay the average rate of Dividend desired.

If the circumstances of the Company are such that the amounts so placed to the credit of the Equalisation Reserve are liable to become locked up in the general assets of the Company, and thus are not readily available for the payment of Cash Dividends when required, it may be desirable that the amounts placed to the credit of the Equalisation Reserve Account should be represented by specific investments, which can then be realised as occasion arises.

SYNOPSIS OF CHAPTER XI.

The Form of Accounts.

1 — THE FORM OF ACCOUNTS

- (a) The Single Account system
- (b) The Double Account system

2 — THE PROFIT AND LOSS ACCOUNT

3 — THE BALANCE SHEET

- (a) Definition
- (b) The Debit Side.
- (c) The Credit Side

4 — THE FORM OF PUBLISHED ACCOUNTS.

5.—THE CRITICISM OF A BALANCE SHEET

CHAPTER XI.

THE FORM OF ACCOUNTS.

§ 1.—The Form of Accounts.

The form in which the Accounts of a Company are prepared is a matter of importance not only to the Shareholders but also to the Directors. The Shareholders are entitled to have the Balance Sheet drawn up in such a manner as to present a true and correct view of the state of the Company's affairs; while the Directors, who are responsible for the conduct of the undertaking, and answerable for its success or failure, should ensure that the detailed Accounts prepared and laid before the Board are drawn up so as to afford the maximum amount of information with respect to the dealings of the Company and its financial position.

Frequently the Auditor is requested to draft the Accounts in the form which he considers most suitable, but if he does this he acts in his capacity as Accountant, and not as Auditor. In any event the Directors are responsible for the form of the Accounts and the Auditor is only concerned if the form adopted by the Directors is one that has the effect of misrepresenting the true position of the Company's affairs, or does not comply with Statutory requirements or the Regulations of the Company. In such cases, where the Auditor cannot persuade the Directors to alter the Accounts, he must report the matter to the Shareholders.

The various forms of Account prescribed by Statute are referred to in Chapter XIV., and it is proposed here to consider the subject generally from the point of view of a Limited Company.

There are two general methods of setting out the position of a Company known as the Single Account system and the Double Account system respectively.

(a) The Single Account System.

The Single Account system is that adopted by most Trading Companies and Private Firms, and the term implies that the state of the affairs is shown in one Account, namely, the Balance Sheet, which sets forth the liabilities and assets of the business, and the balance of profit or loss as the case may be. Under this system the assets of the undertaking should be set out at their value to the business as a going concern. In the case of a Company the excess of such assets over the Shareholders' Capital and the liabilities will represent accumulated profit. It is not necessary that the assets should be shewn at their break-up value, that is, the value which they might be expected to realise upon the immediate cessation of the Company's business, since if this were done most Companies would never be able to pay a dividend at all. A Company is entitled to assume that it is going to continue to carry on business, and accordingly to bring its assets into the Balance Sheet at cost, less proper depreciation.

(b) The Double Account System.

The second method of setting out the Accounts of a Company is that known as the Double Account system under which it may be said the Balance Sheet is divided into two portions, the first portion, termed the Capital Account, recording Capital receipts and

payments, and the second portion, termed the Balance Sheet, recording the balance of the Capital Account, the floating assets and liabilities and the balance of the Revenue Account.

This system is adopted under Statute by certain undertakings such as Railways, Gas Companies and Electric Lighting Companies, and it is adopted by other Parliamentary Companies, such as Water Companies, Dock Companies, &c., where the Capital expenditure is of a heavy nature. The object of the system is to set out clearly the Capital that has been raised for the purposes of the undertaking and the manner in which that Capital has been expended, showing the balance of Capital remaining in hand or over-expended, as the case may be.

Under this system depreciation is not provided for in the same manner as under the Single Account system, as such a procedure would disturb the Capital Account, and consequently, in order that the undertaking may be properly maintained out of revenue, all repairs, renewals, and replacements, should be charged to Revenue as and when they arise. In practice, however, if this principle were adopted, the Revenue Account might be charged with amounts of a very variable nature, and consequently it is desirable to utilise depreciation or renewal funds against which exceptionally heavy renewals can be charged. This particularly applies in the case of new undertakings where the amount of replacement is very small in the early years of the concern, with the result that the balance to the credit of the Revenue Account may be correspondingly greater, and permit of the payment of dividends which would not have been paid if provision had been made for repairs and replacements that must ultimately

be incurred. There would appear to be no direct statutory obligation to provide for future renewals of this nature, but the Auditor should ascertain whether this has been done and if he is of opinion that the provision is inadequate he should draw the attention of the Shareholders to the matter.

Further remarks relative to the operation of the Double Account system will be found in Chapter XV. in connection with the Audits of Gas and Railway Companies.

§ 2.—The Profit and Loss Account.

The Profit and Loss Account is an Account into which all the nominal balances relating to profit or loss are collected, the balance shewing the profit or loss resulting from carrying on business during a given period.

The term Revenue Account is frequently utilised, particularly by Companies working under the Double Account System, where it is not the object of the Company to buy and sell goods at a profit.

The term Income and Expenditure Account is utilised by non-trading concerns, such as Charities, &c., and the balance of the Account represents excess of income over expenditure, or *vice versa*, for a given period.

Whatever title may be given to the Account in all cases it should represent the result of carrying on transactions for a given period. It is intended here to deal with the form of the Profit and Loss Account as affecting a Manufacturing Company.

The Auditor should point out the desirability of the Profit and Loss Account being so framed as to clearly

distinguish between the gross profit, the net profit, and the final balance of profit available for distribution, which is carried to the Balance Sheet.

The Profit and Loss Account should be divided into three Sections, the first part being termed a Trading Account or Manufacturing Account and shewing the gross profit, the second the Profit and Loss Account, showing the net profit or loss, while the third is frequently termed the Profit and Loss Appropriation Account.

The Trading or Manufacturing Account should show on the debit side the commencing stock, the purchases, the wages relating to manufacture, and any other expenses of production such as fuel, &c. On the credit side will appear the sales and the closing stock, and the balance will then represent the gross profit on the manufacturing or trading. Generally speaking, only those items of prime cost that vary directly with the turnover are charged to the Trading Account, but frequently the rent, rates and taxes of the factory, and repairs and depreciation of plant and machinery, are also charged to this Account, although as these items do not vary with the turnover their inclusion may disturb the comparison of the percentage of gross profit on turnover with that of previous periods.

The balance of the Trading Account is carried to the Profit and Loss Account, which should be debited with all expenses of distribution and carrying on the business. All items of expenditure chargeable against the profits must be included, such as Debenture interest, interest on loans, Directors' fees, &c., though it is sometimes convenient to bring down a balance representing the trading profit before charging these items.

If the various classes of expenditure are grouped together under convenient headings the utilisation of a column showing the percentage of each group of expenses to the turnover affords valuable information, and if the Accounts are kept on a uniform basis a comparison of such percentages with those of previous periods is of great advantage.

The last Section of the Profit and Loss Account should show the balance of profit or loss carried forward from the previous period, the net profit or loss for the current period, together with any interim dividends paid to Shareholders, or other appropriations of profit, the final balance representing the balance of the Profit and Loss Account as appearing in the Balance Sheet.

§ 3.—The Balance Sheet.

(a) Definition.

A Balance Sheet is frequently termed a Statement of liabilities and assets, but this definition is incomplete, as in many cases items are included on the liabilities side which are not strictly speaking liabilities, such as balance of the Profit and Loss Account, Reserve Funds, &c., while on the assets side such items may appear as accumulated loss to the debit of the Profit and Loss Account, expenditure carried forward not represented by any available assets, &c.

A Balance Sheet may therefore be more properly defined as a classified summary of the balances remaining in a set of books after those relating to profit and loss have been collected into one Account, and including the balance of that Account, so arranged as to show the assets and debit balances upon one side and the liabilities and credit balances upon the other.

The Balance Sheet represents the culmination of the system of book-keeping, and should be a document setting out the true position of the business in such a manner as may be easily understood by men of business intelligence.

(b) The Debit Side.

On the debit side the Authorised Capital of the Company should be set out, and where this is divided into different classes of shares the necessary details should be given. The issued Capital should follow showing the number of shares issued and the amount called up in respect thereof. From this should be deducted the calls in arrear; any calls paid in advance should be added, the final total being extended in respect of each class of Capital, representing the amount contributed by the Shareholders.

Any sums received in respect of forfeited shares should be shown separately, after the necessary adjustments have been made referred to in Chapter IX., § 2 (b).

If Debentures have been issued these should be next shown. It is not necessary to insert the authorised amount of the Debenture issue, and only the issued amount is as a rule set out. Any accrued interest on the Debentures should be stated separately. The treatment of Debentures issued at a discount or at a premium has already been dealt with in Chapter IX., § 4.

Loans on Mortgage should be shown separately, together with interest accrued thereon, and should not be included among other creditors; and similar remarks apply to creditors for loans unsecured, and bank overdraft (if any). An overdraft at one bank should not be set off against a credit balance at another.

The term Sundry Creditors is utilised to cover all other unsecured liabilities, the item being usually divided between creditors on Open Account and Bills Payable.

Unclaimed dividends should show as a separate item.

Any amount to the credit of General Reserve Account or Reserve Fund, any Sinking Fund for the redemption of liabilities or Depreciation Fund for the replacement of assets, should be shown separately.

The final balance standing to the credit of Profit and Loss Account, if any, will be the last item, and it is usual in some cases to set out in detail in the Balance Sheet the Profit and Loss Appropriation Account, showing how the final balance available is arrived at.

A note should be made of any contingent liabilities in respect of Bills discounted, or otherwise.

(c) The Credit Side.

There is no hard-and-fast rule as to the order in which assets should be placed on the credit side of the Balance Sheet, although in most cases it is preferable to start with the Fixed Assets in their natural order, following on with the Floating Assets in order of realisation. Where, however, as in the case of a Bank, it is desired that particular attention should be drawn to the Liquid Assets of the Company, it is preferable to commence with those assets, such as cash, &c., and to end with the Fixed Assets.

In the case of Fixed Assets care should be taken to see that the various classes of such assets are shown separately. For instance, goodwill should be shown separately and not mixed up with freehold or

leasehold property, or with plant and machinery. Fixed Assets should be stated at cost or less depreciation, as the case may be.

In a similar manner Floating Assets should be distinguished according to their various classes.

Where a Company holds Investments these should be subdivided according to the nature of the security, and it should be clearly indicated whether they are taken credit for at cost or at market value. Where the market value is less than book value, and provision for depreciation has not been made, a note of the market value should be inserted.

Where shares are held in other Companies to which contingent liability attaches owing to the fact that the shares are not fully paid up a note should be made of the contingent liability. Investments specifically made to represent a Reserve Fund or Sinking Fund should be shown separately.

Where, as in the case of Contractors' Accounts, the item "Work in progress" appears, this should be shown separately in the Balance Sheet, and if any profit has been taken in respect of Contracts not yet completed, it is desirable that the wording should indicate this. Where sums have been received in respect of Contracts before completion the amounts so received should be deducted from "Work in progress," and not shown on the debit side of the Balance Sheet.

Where it is the business of the Company to make loans on mortgage these will appear as a separate item, and in all cases where advances have been made the amount should appear under a separate heading and not be included under Sundry Debtors or Investments.

The amounts due from Sundry Debtors should be shown less the amount reserved in respect of bad debts or discount. The item should not include balances representing goods out on sale or return, consigned stocks, or stocks in the hands of Agents. The proper treatment of these items has been considered in Chapter III., and the amount should either be shown separately or included in the general item "Stock-in-trade." Bills Receivable should be shown separately.

It is desirable that the item Cash should be divided as between Cash on Deposit, on Current Account, and In Hand respectively.

Where the Balance Sheet contains items of expenditure not represented by available assets the nature thereof should be clearly indicated. Expenditure paid in advance, such as rent, rates and insurance, should be shown separately under the heading of "Payments in advance." The balance of Preliminary Expenses not written off should appear as a separate item and must not include any underwriting Commission, or Commission on placing shares, which must appear separately in every Balance Sheet until written off, in accordance with § 90 of the Companies Consolidation Act, 1908. Similarly, Expenses of issuing Debentures, or Discount on issue of Debentures, must be shown under their respective headings.

In some instances it is permissible to carry forward expenditure the benefit of which is not entirely exhausted and instances of this treatment have been afforded in Chapter IV., § 4. In each case the wording of the item should be self-explanatory. Sometimes accumulated losses on Capital Account are written off the various assets concerned and charged to a Suspense or Deficiency Account pending re-organization of the

Company's Capital. Where this is so the item should be clearly worded.

If there is a debit balance to the Profit and Loss Account representing accumulated losses this will appear on the credit side of the Balance Sheet, and it is desirable that the item should be worded so as to clearly indicate that it represents loss.

§ 4.—The Form of Published Accounts.

Apart from those Companies where the form of published Accounts is obligatory by Statute, considerable differences may be observed in the manner in which Accounts are published, or presented to the Shareholders.

In Trading Companies it is not usual to publish a Trading or Manufacturing Account, as this would possibly disclose information to trade rivals which would be detrimental to the interests of the Company. It is, however, usual to find a Profit and Loss Account published showing upon the credit side the gross profit, and upon the debit side the various expenses set out in such detail as the Directors think desirable in the interests of the Company. As long as the form of the Account is not misleading it is not within the province of the Auditor to object to the manner in which the Directors desire it to be published, since they must be regarded as the best judges of the Company's interests. Moreover, the Shareholders are entitled to ask for fuller Accounts should they wish to receive them, and the matter can be discussed at the General Meeting. In some cases it is found that no Profit and

Account is published at all, or that merely a Profit and Loss Appropriation Account is shown. It

depends of course upon the requirements of the Articles of Association as to what information is afforded, but if the Articles permit of such treatment there is nothing to prevent the Directors publishing a Balance Sheet alone, unsupported by any form of Profit and Loss Account, although this cannot be said to be desirable except in special cases.

The question as to how far the Balance Sheet may be condensed for the purpose of publication is a somewhat difficult one. In the previous Section the general manner in which a Balance Sheet should be set out has been indicated. Where, however, the Directors do not wish to publish the Balance Sheet in a form which meets with the Auditors approval he must consider carefully the form which they propose, and if it in any way has the effect of making the position of the Company look better than it really is, or infringes any Statutory regulations or the Articles of the Company, and he cannot induce the Directors to alter the form, he must deal with the matter in his Report to the Shareholders.

§ 5.—The Criticism of a Balance Sheet.

It may be convenient here to make a few remarks relative to the criticism of a Balance Sheet apart altogether from the point of view of the Auditor of the Company concerned, as it sometimes happens that a Professional Accountant is requested to advise a client on the financial position of a Company, or on the value of shares held therein, in cases where there is no free market.

The first point to which attention should be directed is the authorised and issued Share Capital. If the latter is not fully paid up the amount of the uncalled,

liability should be ascertained, and it should be seen whether this can be called up in the ordinary course for the purposes of the Company or is only available in the case of liquidation. Any calls in arrear should be noted as if these are large in amount it is possible they may not be recoverable in full. In the event of Preference, Founders' or Deferred Shares existing the rights of the respective Shareholders, *inter se*, should be ascertained.

In the case of any Mortgage Debentures having been issued it should be ascertained whether they are secured by a Floating Charge on the undertaking or by a Fixed Charge on specific assets, and whether the charge covers uncalled Capital, if any. For this purpose reference should be made to the Company's Register of Mortgages, and to the Register kept at Somerset House.

In order to ascertain the working Capital at the command of the Company, the Floating Assets of a realisable nature should be compared with the current liabilities. If the latter exceed the former, although there may be fixed assets of considerable value available to meet the claims of the creditors, the position from the point of view of working Capital is unsatisfactory.

The amounts under the heading of Creditors should be examined and, if possible, it should be seen whether any items relate to loans unsecured or otherwise, overdraft at the Bank, &c., since Creditors of this nature differ materially from trade creditors.

If a Reserve Fund appears it should be seen whether it is represented by specific investments on the other side of the Balance Sheet and if so, whether the present value of such investments is equivalent to the fund. The nature of the securities should be ascertained.

Where the Reserve Fund is not represented by such investments it should be termed a Reserve Account, and it will entirely depend upon the valuation placed upon the assets as to whether such reserve exists. It is clear that if sufficient depreciation has not been provided in respect of Fixed Assets, or if the Floating Assets have been over-valued, the Reserve may have been built up by appropriations of profit which would not have been available had the Balance Sheet been prepared upon a proper basis. Consequently, the Reserve may be wholly or in part a paper one which cannot be taken into account in estimating the financial position of the concern.

In the case of a Public Company the Statement in the form of a Balance Sheet filed with the Annual Summary at Somerset House must state how the values of the fixed assets have been arrived at, and should be consulted. The Company's file at Somerset House should be searched as it might afford useful information.

If Goodwill appears, the value attaching to it should be examined in relation to the profits earned by the business, as this will afford some indication as to whether the item is reasonable or excessive. It should be ascertained whether sufficient reserves have been made for bad debts or for other anticipated losses.

Any items of expenditure carried forward in suspense, payments made in advance, &c., should be noted as such items are not of a realisable nature.

The Cash balance should be observed particularly in relation to the balance of profit carried forward, if any.

The rates of dividends paid should be ascertained and whether there are any arrears of Cumulative Preference Dividend. Where the Auditor's Report is published it should be referred to.

Where it is desired to value the shares in a Company which has no free market, the Balance Sheets and Profit and Loss accounts for the last five to ten years should be examined, and the profits earned, the rates of dividends paid, appropriations to reserve and balances carried forward should be noted.

Where a valuation is being made from the point of view of a seller, it is important to ascertain the extent of any secret reserves that may exist, either in the shape of excessive depreciation having been provided for, or over reserves for bad debts and other contingencies. It should also be seen that the Stock has not been written down below its real value.

From the point of view of a purchaser, it should be seen that proper depreciation has been provided, that none of the assets are over valued, and that adequate reserve is made against bad debts and other losses. In either case the value placed upon Goodwill should be considered in relation to the profits earned and the nature of the business carried on.

In the case of Ordinary Shares where Preference Shares exist with prior rights as to repayment of capital, the net value of the assets should be ascertained in accordance with the above suggestions, and after deducting liabilities and appropriate reserves for anticipated losses, the preference capital should then be deducted and the balance should represent the capital value of the Ordinary Shares. The figure so arrived at must be taken in conjunction with the rates of dividends that have been paid but the result may not represent the saleable value of the shares particularly in the case of a Private Company where the right of transfer is restricted. It will, however, afford a basis of negotiations as to the price.

SYNOPSIS OF CHAPTER XII.

The Liability of Auditors.

§ 1 — THE LIABILITY OF AUDITORS

2 — LIABILITY UNDER STATUTE.

- (a) Companies (Consolidation) Act, 1908, § 210
- (b) Ditto ditto § 251
- (c) The Larceny Act, 1861.
- (d) The Falsification of Account Act 1875

3.—LEGAL DECISIONS

- (a) Leeds Estate Building and Investment Co v Shepherd.
- (b) In re London and General Bank.
- (c) In re The Kingston Cotton Mill Co, Ltd.
- (d) The Irish Woollen Co, Ltd v Lyson and others
- (e) The London Oil Storage Co, Ltd v Scott, Hasluck & Co.

4 —LEGAL DECISIONS CONSIDERED

- (a) Liability for Negligence under Common Law.
- (b) Liability for Mistake.

CHAPTER XII.

THE LIABILITY OF AUDITORS.

§ 1.—The Liability of Auditors.

The question as to what liability an Auditor is under in relation to the Accounts he has audited, is a very difficult one to determine. A number of decisions have been given in the Courts, and these will be dealt with below, but it may be useful to summarise here the various kinds of liabilities to which Auditors are subject :

- 1 (1) Liability to be held responsible for any errors or defalcations which by reason of negligence on the part of the Auditor have not been discovered, and to make good any damage resulting from such negligence.
- 1 (2) Liability to be held an officer of the Company under section 215 of the Companies (Consolidation) Act, 1908, and, as such, liable in the event of winding up to contribute to the Company any loss occasioned by misfeasance or breach of trust on his part.
- 1 (3) Liability to fine, imprisonment, or both under section 281 of the Companies (Consolidation) Act, 1908, for wilfully making in any report, balance sheet or other document, a statement false in any material point, knowing it to be false.
- 1 (4) A similar liability under section 84 of the Larceny Act, 1861.

§ 2.—Liability under Statute.

(a) Companies (Consolidation) Act, 1908, § 215.

The Auditor can only be held liable for misfeasance under § 215 of the Companies (Consolidation) Act, 1908, if he is held to be an Officer of the Company. The question as to whether an Auditor is in all cases an Officer of a Company has been considered in Chapter VI., § 2 (b). It is probable that an Auditor would be held to be an Officer of the Company, in so far as his duties as Auditor are concerned, and accordingly he may in certain circumstances find himself liable to be treated as such under this section, which reads as follows:—

✓ 215.—(1) Where in the course of winding up a company it appears that any person who has taken part in the formation or promotion of the company, or any past or present director, manager, or liquidator, or any officer of the company, has misapplied or retained or become liable or accountable for any money or property of the company, or been guilty of any misfeasance or breach of trust in relation to the company, the court may, on the application of the official receiver, or of the liquidator, or of any creditor or contributory, examine into the conduct of the promoter, director, manager, liquidator, or officer, and compel him to repay or restore the money or property or any part thereof respectively with interest at such rate as the court thinks just, or to contribute such sum to the assets of the company by way of compensation in respect of the misapplication, retainer, misfeasance, or breach of trust as the court thinks just.

(2) This section shall apply notwithstanding that the offence is one for which the offender may be criminally responsible.

This section replaced § 10 of the Companies (Winding-up) Act, 1890, and it should be remembered that liability thereunder can only operate in the case of the winding-up of a Company.

(b) Companies (Consolidation) Act, 1908, § 281.

In the event of the Auditor in any Report, Certificate, Balance Sheet, or other document, wilfully making a statement false in any material particular, knowing it to be false, he may be criminally liable

under § 281 of the Companies (Consolidation) Act, 1908, which reads as follows :—

✓ 281 If any person in any return, report, certificate, balance sheet, or other document, required by or for the purposes of any of the provisions of this Act specified in the Fifth Schedule hereto, wilfully makes a statement false in any material particular, knowing it to be false he shall be guilty of a misdemeanor, and shall be liable *on conviction on indictment to imprisonment for a term not exceeding two years, with or without hard labour, and on summary conviction to imprisonment for a term not exceeding four months, with or without hard labour, and in either case to a fine in lieu of or in addition to such imprisonment as aforesaid*

Provided that the fine imposed on summary conviction shall not exceed one hundred pounds

The words printed in italics were repealed and substantially re-enacted by the Perjury Act, 1911 (§ 5).

It will be observed that conviction under this section will not operate to relieve the Auditor from liability for misfeasance under § 215.

(c) The Larceny Act, 1861.

Section 81 of this Act provides that Directors, Members, or Public Officers of any body corporate or public body, fraudulently appropriating the property of the Company, shall be guilty of misdemeanor, and a similar liability attaches to persons who may keep or direct to be kept the accounts of the Company in a fraudulent manner for purposes of concealing such misfeasance.

Section 83 extends similar liability in cases where such persons, with intent to defraud, wilfully destroy, alter, mutilate, or falsify any books, papers, or documents belonging to the Company.

It is not likely that an Auditor, as such, could come within the operations of the above sections, but § 84 deals with publishing false statements, and might in certain cases be brought into operation against the Auditor. The wording of this section is as follows :—

84. Whoever, being a director, manager, or public officer of any body corporate or public company, shall make, circulate, or

publish, or concur in making, circulating, or publishing, any written statement or account which he shall know to be false in any material particular, with intent to deceive or defraud any member, shareholder, or creditor of such body corporate or public company, or with intent to induce any person to become a shareholder or partner therein, or to entrust or advance any property to such body corporate or public company, or to enter into any security for the benefit thereof, shall be guilty of a misdemeanour, and being convicted thereof shall be liable, at the discretion of the court, to any of the punishments which the court may award as hereinafter last mentioned.

In the case of *Dumbell's Banking Company, Limited* (1900 Aect. L. R. 181), the prosecution was instituted against the Directors and Auditors of the Company under the Manx Criminal Code, 1872, § 221, which is identical with § 84 of the Larceny Act, 1861, quoted above. The Jury found all the defendants guilty, including the Auditors, and they were sentenced to varying terms of imprisonment.

It was under §§ 83 and 84 of this Act that the prosecution in the case of *Rex v. Whitaker Wright* (1904 Aect. L. R. 14) was conducted, under which the defendant was found guilty, and sentenced to penal servitude for seven years.

(d) The Falsification of Accounts Act, 1875.

This Act is required to be read in conjunction with the Larceny Act, 1861, and consists of the following Sections:—

1. That if any clerk, officer, or servant, or any person employed or acting in the capacity of a clerk, officer, or servant, shall wilfully and with intent to defraud, destroy, alter, mutilate, or falsify any book, paper, writing, valuable security, or account which belongs to or is in the possession of his employer, or has been received by him for or on behalf of his employer, or shall wilfully, and with intent to defraud, make, or concur in making, any false entry in, or omit or alter, or concur in omitting or altering, any material particular from; or in any such book, or any document or account, then in every such case the person so offending shall be guilty of a misdemeanour, and be liable to be kept in penal servitude for a term not exceeding seven years, or to be imprisoned with or without hard labour for any term not exceeding two years.

2 It shall be sufficient in any indictment under this Act to allege a general intent to defraud without naming any particular person to be defrauded.

§ 3. Legal Decisions.

(a) *Leeds Estate Building and Investment Co.* **Shepherd.**
1887 (1 Ch D 187)

Held that an Auditor who is charged in the particular charges is liable in damages.

This company was formed for the purpose of dealing in loans and lending money on mortgage; the remuneration of the Directors was payable in proportion to the dividend paid, no dividend being payable except out of profits. No profit was made by the Company during the whole period in which it carried on business, except in one year. The action was brought by the Company against the Directors, the Manager, and the Auditors, to make them liable in respect of certain sums paid out of Capital for dividend, and the fees and bonuses of Directors and Manager respectively. The Balance Sheets were false and misleading, and contained fictitious items being prepared with a view to the declaration of dividends.

The accounts were examined by the Auditor, but he was not furnished with a copy of the Articles, and he did not comply with their provisions. The Directors were not aware that dividends had been paid out of Capital, or that the Balance Sheets were inaccurate.

In the course of His Judgment, Stirling, J., said:—

"It is the duty of the auditor not to confine himself merely to the task of ascertaining the arithmetical accuracy of the balance sheet, but to see that it is a true and accurate representation of the Company's affairs. It was no excuse that the auditor had not seen the articles when he knew of their existence. The statute of Limitations had been pleaded on his behalf, and the plea had not been resisted, so that his liability would be limited to the dividends paid within six years of the commencement of the action."

(b) *In re London and General Bank* (No. 2.) (1895, 2 Ch. 682.)

Held that an Auditor, who does not report to the Shareholders the facts of the case when the Balance Sheet is not properly drawn up, is guilty of misfeasance.

This case was heard after it had been determined by the Court of Appeal that the Auditor of the Company was an Officer of the Company within the meaning of the Companies (Winding-up) Act, 1890 (*in re London & General Bank*, No. 1, 1895, 2 Ch. 166). So far as this point of view is concerned, the case has already been considered in Chapter VI., § 2 (b).

This was an Appeal by Mr. Theobald, one of the Auditors of the London & General Bank, which was being wound up, against an order made by Vaughan Williams, J., under § 10 of the Companies (Winding-up) Act, 1890. By this order Mr. Theobald and the Directors of the Bank were declared jointly and severally liable to pay to the Official Receiver of the Company two sums of £5,456 12s. and £8,486 11s., being respectively the amounts of dividends declared and paid by the Bank for the years 1890 and 1891, with interest on those sums. The grounds on which this order was made on Mr. Theobald were that these dividends were paid out of Capital, and that such payment was made pursuant to Resolutions of the Shareholders, based upon the recommendation of the Directors of the Bank, and Balance Sheets, prepared and certified by Mr. Theobald, which did not fully represent the financial position of the Company.

The failure of the Company was principally due to the fact that large sums had been advanced to customers on loan and current account, in respect of which the security lodged was entirely insufficient, and the dividends in question were paid out of sums taken to

the credit of profit and loss in respect of interest on such advances, which interest was never, as a fact, paid. Had proper provision been made for bad debts in respect of sums advanced, and interest accrued thereon, the accounts of the Company would not have shown a profit, but a loss.

The Court held that the Auditor was liable to refund, by way of damages, the amount of the second dividend, on the ground that he was aware of the critical position of affairs, and acted negligently in not reporting the facts to the Shareholders, although he reported them to the Directors. As regards the first dividend, the Court did not hold the Auditor liable, as it was of opinion that the evidence was not sufficiently strong to establish a case of misfeasance against him, although it thought he was guilty of an error of judgment.

In the course of his Judgment, Lindley, L.J., said (Acct. L.R. 1895, 173): -

"It is no part of an auditor's duty to give advice either to directors or shareholders as to what they ought to do. An auditor has nothing to do with the prudence or imprudence of making loans with or without security. It is nothing to him whether the business of a company is being conducted prudently or imprudently, profitably or unprofitably; it is nothing to him whether dividends are properly or improperly declared, provided he discharges his own duty to the shareholders. His business is to ascertain and state the true financial position of the company at the time of the audit and his duty is confined to that. But then comes the question: How is he to ascertain such position? The answer is: By examining the books of the company. But he does not discharge his duty by doing this without enquiry, and without taking any trouble to see that the books of the company themselves show the company's true position. He must take reasonable care to ascertain that they do. Unless he does this, his duty will be worse than a farce. Assuming the books to be so kept as to show the true position of the company, the auditor has to frame a balance-sheet showing that position according to the books, and to certify that the balance-sheet presented is correct in that sense. But his first duty is to examine the books, not merely for the purpose of ascertaining what they do show, but also for the purpose of satisfying himself that they show the true financial position of the company.

AN auditor, however, is not bound to do more than exercise reasonable care and skill in making inquiries and investigations. He is not an insurer; he does not guarantee that the books do correctly show the true position of the company's affairs; he does not guarantee that his balance-sheet is accurate according to the books of the company. If he did, he would be responsible for an error on his part, even if he were himself deceived, without any want of reasonable care on his part—say by the fraudulent concealment of a book from him. His obligation is not so onerous as this.

Such I take to be the duty of the auditor; he must be honest—that is, he must not certify what he does not believe to be true, and he must take reasonable care and skill before he believes that what he certifies is true.

What is reasonable care in any particular case must depend upon the circumstances of that case. Where there is nothing to excite suspicion, very little enquiry will be reasonable and quite sufficient; and in practice, I believe, business men select a few cases haphazard, see that they are right, and assume that others like them are correct also. When suspicion is aroused, more care is obviously necessary; but still, an auditor is not bound to exercise more than reasonable care and skill, even in a case of suspicion; and he is perfectly justified in acting on the opinion of an expert where special knowledge is required.

A person whose duty it is to convey information to others does not discharge that duty by simply giving them so much information as is calculated to induce them, or some of them, to ask for more. Information and means of information are by no means equivalent terms. . . . An auditor who gives shareholders means of information, instead of information, in respect of a company's financial position, does so at his peril, and runs the very serious risk of being held, judicially, to have failed to discharge his duty.

In this case I have no hesitation in saying that Mr. Theobald did fail to discharge his duty to the shareholders, in certifying and laying before them the balance-sheet of February, 1892, without any reference to the report which he laid before the directors, and with no other warning than is conveyed by the words, "The value of the assets as shown on the balance-sheet is dependent upon realisation. . . ." It is a mere truism to say that the value of loans and securities depends upon their realisation. We are told that a statement to that effect is so unusual that the mere presence of those words is enough to excite suspicion. But, as already stated, the duty of an auditor is to convey information, not to arouse inquiry, and although an auditor might infer from an unusual statement that something was seriously wrong, it by no means follows that ordinary people would have their suspicions aroused by a similar statement if, as in this case, its language expresses no more than any ordinary person would infer without it."

In the course of his Judgment, Rigby, L.J., said:—

"The words 'as shown by the books of the company' seem to me to be introduced to relieve the auditors from any responsibility

as to affairs of the company kept out of the books and concealed from them, but not to confine it to a mere statement of the correspondence of the balance-sheet with the entries in the books. Now, a full and fair balance sheet must be such a balance sheet as to convey a truthful statement as to the company's position. It must not conceal any known cause of weakness in the financial position, or suggest anything which cannot be supported as fairly correct in a business point of view."

(c) *In re The Kingston Cotton Mill Co., Limited* (No. 2) (1896, 1 Ch. 331)

Held that it is not the duty of the Auditor to take stock; and that he is not guilty of negligence if he accepts the certificate of a responsible official in the absence of suspicious circumstances.

This case was heard after it had been determined by the Court of Appeal that the Auditors of the Company were Officers of the Company within the meaning of the Companies (Winding-up) Act, 1890 (*In re Kingston Cotton Mill Company, Ltd.* (No. 1), 1896, 1 Ch. 6). So far as this point of view is concerned, the case has already been considered in Chapter VI., § 2 (b).

This was an appeal by the Auditors of the Kingston Cotton Mill Company, Ltd. (then in liquidation), against an Order made by Vaughan Williams, J., under § 10 of the Companies (Winding-up) Act, 1890, under which they were made liable to make good to the assets of the Company moneys of the Company improperly applied in payment of dividends on the faith of certain Balance Sheets certified by them. The profits of the Company were fictitiously increased by deliberate manipulation of the quantities and values of the Stock-in-Trade, and the question was, whether the Auditors were guilty of negligence in accepting the certificate of the Manager as to the correctness of the Stock-in-Trade without checking the stock in detail. The facts

of the case appear sufficiently from the following extract from the Judgment of Lindley, L.J. (Acct. L.R. 1896, 77).

"For several years frauds were committed by the manager, who in order to bolster up the company and make it appear flourishing when it was the reverse, deliberately exaggerated both the quantities and values of the cotton and yarn in the company's mills. . . . The auditors took the entry of the stock-in-trade at the beginning of the year from the last preceding balance-sheet, and they took the values of the stock-in-trade at the end of the year from the stock journal. The book contained a series of accounts under various heads purporting to show the quantities and values of the company's stock-in-trade at the end of each year, and a summary of all the accounts showing the total value of such stock-in-trade. The summary was signed by the manager, and the value as shown by it was adopted by the auditors and was inserted as an asset in the balance-sheet, but 'as per manager's certificate.' The summary always corresponded with the accounts summarised, and the auditors ascertained that this was the case. But they did not examine further into the accuracy of the accounts summarised. The auditors did not profess to guarantee the correctness of this item. They assumed no responsibility for it. They took the item from the manager, and the entry in the balance-sheet showed that they did so. I confess I cannot see that their omission to check his returns was a breach of their duty to the Company. It is no part of the auditor's duty to take stock. No one contends that it is. He must rely on other people for details of the stock-in-trade in hand. In the case of a cotton mill he must rely on some skilled person for the materials necessary to enable him to enter the stock-in-trade at its proper value in the balance-sheet."

Lopes, L.J., in the course of his Judgment made the following remarks :

"It is the duty of an auditor to bring to bear on the work he has to perform that skill, care and caution which a reasonably competent, careful and cautious auditor would use. What is reasonable skill, care and caution must depend on the particular circumstances of each case. An auditor is not bound to be a detective, or, as was said, to approach his work with suspicion or with a foregone conclusion that there is something wrong. He is a watch-dog, but not a bloodhound. He is justified in believing tried servants of the company in whom confidence is placed by the company. He is entitled to assume that they are honest, and to rely upon their representations, provided he takes reasonable care. If there is anything calculated to excite suspicion he should probe it to the bottom, but in the absence of anything of that kind, he is only bound to be reasonably cautious and careful. . . . The duties of auditors must not be rendered too onerous. Their work is responsible and laborious, and the remuneration

ation moderate. I should be sorry to see the liability of auditors extended any further than in *In re The London & General Bank (supra)*. Indeed, I only assented to that decision on account of the inconsistency of the statement made to the directors with the balance-sheet certified by the auditors and presented to the shareholders. This satisfied my mind that the auditors deliberately concealed that from the shareholders, which they had communicated to the directors. It would be difficult to say this was not a breach of duty. Auditors must not be made liable for not tracking out ingenious and carefully-laid schemes of fraud, when there is nothing to arouse suspicion and when those frauds are perpetrated by tried servants of the company and are undetected for years by the directors. So to hold would make the position of an auditor intolerable.

(d) *The Irish Woollen Co., Limited, v. Fyson and Others.*
(1900 Acct., L.R. 13)

Held that an Auditor is liable for any damage sustained by a Company by reason of falsifications which might have been discovered by the exercise of reasonable care and skill in the performance of the Audit.

This case was heard before the Irish Court of Appeal, and was an appeal by Mr. Edward Kevans, the Auditor, against the Judgment of the Lower Court, holding him responsible for the non-detection of the fraud. The Appeal was dismissed.

The frauds were principally occasioned by the suppression of Invoices outstanding at the date of the Balance Sheet, thus reducing the amount of purchases and the amount of creditors. The goods, however, were taken into stock and a fictitious profit was therefore shown to that extent. This amounted ultimately to £4,095.

The Court gave considerable weight to the fact that a special arrangement was come to between the Company and the Auditor, for a monthly Audit to be conducted, which should lead up to the half-yearly Audit. This monthly Audit consisted merely in

checking the current details and did not involve the preparation of monthly Profit and Loss Accounts or Balance Sheets.

In the course of his Judgment, Holmes, L.J., said: -

Mr. Keyms seems to have done little of the actual work himself, and the evidence goes to the nature of the supervision which he gave to it. The investigation of the books he delegated to his assistants, and it must be on the faith of their representations that he certified the balance sheet. I presume this course is not unusual and that an accountant with this business is not supposed to do everything himself. The auditor is bound to give reasonable care and skill but this can be done only by his deputy. There is no doubt that both the appropriation and carrying over of invoices would have been detected if the auditor had called for the creditor's statement of account upon which payment was ordered and compared them with the ledger. I should have thought this was part of the auditor's duty for many reasons, but apart altogether from the statements of account and the monthly check, I do not understand how the carrying over of the invoices could have escaped detection by the accountant who should have used due care and skill and who was not a mere machine. The invoices carried over were ultimately posted to the ledger. If they were posted to their true dates it would be at once apparent that they were not entered in at the proper time. If they were posted under false dates, why was this not detected when the ledger accounts were checked with the invoices? And when no invoices came into the books it is admitted that this ought to have excited suspicion. For these reasons I am of opinion that if due care and skill had been exercised, the carrying over and the suppression of invoices would have been discovered and the auditor is liable in damages the company has sustained from the understatement of liability in the balance sheet due to this course since January 1st 1892. I consider that not only are Mr. Keyms and his assistants not free from blame for this, but also for the mechanical way the audit was carried out.

(c) *The London Oil Storage Co., Limited, v. Seeal, Hasluck & Co.* (1901 A.C. 118, 311)

Held, that an Auditor is liable for any damage sustained by a Company by reason of his omission to verify the existence of Assets stated in the Balance Sheet.

This was an Action brought by the Company for damages for alleged neglect by the Auditor in omitting

to verify the existence of a sum of about £700, 'shown in the Balance Sheet as Petty Cash in hand. As a fact, the balance in hand was only £30, and the difference had been misappropriated by the Secretary, who kept the Petty Cash Book.

The Auditor's clerk did not count the balance of cash in hand, but merely referred to the Petty Cash Book, to see that the amount shown in that book agreed with the amount shown in the Balance Sheet.

This case was heard before Alverstone, C.J., and a Special Jury, with the result that the Jury found the Auditor had committed a breach of duty, and assessed the damages at five guineas. The Jury considered that the Directors had been guilty of gross negligence in allowing such a large balance of cash to remain in the hands of the Petty Cashier, and it was owing to this fact that the damages given against the Auditor were of such a nominal amount.

In the course of his summing-up, Alverstone, C.J., said :

"The auditor most undoubtedly does undertake very considerable responsibilities and is liable for the proper discharge of his duties, and if by the neglect of his duties or by want of reasonable care, he neglects his duty and damage is caused to the company as such, he is responsible for that damage. The plaintiffs must satisfy you that the damage has been occasioned, to whatever extent you think it was occasioned by the breach of duty on the part of the auditor. The conduct of the directors is no answer to any breach of duty by the defendant, but it is a circumstance you must take into consideration, because if you are of opinion that the loss was occasioned by the man stealing the money in consequence of there being a want of proper control over him, then the fact of there being a breach of duty by the auditor is what we lawyers call a *causa causans*, which contributed to, but would not be the cause of, the loss. . . . Was he guilty of breach of duty, and, if so, what loss was occasioned to this company by that breach of duty? You must not put upon him the loss by reason of theft occurring afterwards or before, but you must put upon him such damages as you consider in your opinion were really caused by his not having fulfilled his duty as auditor of the company."

§ 4.—Legal Decisions Considered.

(a) Liability for Negligence under Common Law.

Every Agent is presumed to bring reasonable skill and diligence to bear upon the work which he is employed to do, and an Auditor, who may be said to be an Agent to the extent of his duties as Auditor, is no exception to this rule. If, therefore, an Auditor is guilty of negligence in the execution of his duty, he may be held liable to make good any damage resulting from such negligence.

This liability arises under the ordinary law of contract, and the question as to whether the Auditor is subject to it in any particular case, will depend entirely upon the circumstances. In the present state of Professional Accountancy, the general average of skill and diligence attained by Auditors has reached a high standard, and the question as to whether an Auditor is or is not guilty of negligence in any particular case, is largely determined by a comparison with the standard to which the principal members of the profession conform.

It has already been pointed out that it is extremely important for the Auditor of a private firm to have a clear understanding with his clients as to the extent of his responsibility. This was illustrated in the case of *Wilde and Others v. Cape & Dalgleish* (1897, "Times," 28th May), where, owing to the Auditors omitting to examine the Pass Book, frauds were not discovered. The defence in this case was that an Audit of the Cash transactions was not part of the original arrangement, but this could not be substantiated, and a settlement was arrived at.

A further instance of the Auditor's liability in this connection is to be found in the case of *Smith v. Sheard*

(1906, 34 Acct. L. R. 65). The defence in this instance was that no agreement to perform an Audit had ever been come to; an actual Audit was not performed, and as a result defalcations were not discovered. The defence, however, was not substantiated, and the Auditors were held liable, although no certificate was placed by them on the accounts. The absence of such certificate, therefore, though it may have an important bearing on the result, will not of itself be sufficient to free the Auditor from liability.

In the case of *Chen, Fox & Sons v. Morris Grant & Co.* (1918, 59 Acct. L.R. 29), the Accountants were employed to check the books and prepare accounts, but they did not examine the pass-book, and were held liable for damages in consequence of defalcations arising which would have been discovered had the pass-book been examined. The defence was that no audit was undertaken, and that it was not necessary to examine the pass-book in checking the mathematical accuracy of the books and preparing accounts. The Court held, however, that the checking of the books and the preparation of accounts under the circumstances in question, where "Cash at Bank" was inserted in the Balance Sheet by the Accountants, implied a duty on their part to see that this asset actually existed.

The whole question in these cases is as to the precise terms of the agreement, and unless the limitations of responsibility are very clearly defined between the parties, the Accountant or Auditor should regard himself as under as much responsibility as if he were conducting a complete Audit.

In the case of *Martin v. Isitt* (1898, Acct. L. R. 41), a similar fraud took place. One of the terms of the contract for the Audit was that it should be a monthly

one, but although the fraud commenced in November, 1896, it was not discovered by the Auditors until April, 1897, thus enabling the defalcations to be continued during that period. The defence was that the delay was occasioned by the state of the books, but a settlement was ultimately arrived at.

The failure to detect defalcations was the occasion of the case of the *Astrachan Steamship Company, Ltd., and Others, v. Harwood Bannet & Son* (1900, "Liverpool Mercury," 2nd and 3rd March), where an Action was brought for damages for alleged negligence, which was ultimately settled in favour of the plaintiffs.

In the case of the *London Oil Storage Company, Ltd., v. Secar, Haseluck & Co.* (1904, Acct. L. R. 31, 1), it was held that it is the duty of the Auditor of a Company to take proper steps to verify the existence of Assets. The point arose in connection with the verification of the Petty Cash Balance, which was shown by the books to be £700, but the amount in hand was actually found to be only £30. The Auditor contended that his duties ended when he had seen that the entries in the books created an Asset. The absurdity of such a contention is manifest, and it was found that the Auditor had committed a breach of duty in not vouching the existence of the Cash in hand. The damages against the Auditor were assessed at five guineas, the Jury stating that in their opinion the Directors had been guilty of gross negligence in allowing so large a sum to remain in the hands of the Petty Cashier. This is important, as illustrating the point that the Auditor is only liable for such damages as were actually occasioned by the act of negligence.

An Auditor has been held liable for omitting to detect fraudulent suppression, or carrying over of Invoices

for goods purchased, the Court holding in the particular circumstances that he ought to have discovered the fraud by the exercise of reasonable skill and diligence. This portion of the Audit was not performed by the Auditor himself, but by his clerks, and the Court stated that although the Auditor is bound to give reasonable care and skill, this can also be exercised by his deputy. At the same time, if the deputy fails in his duty, the responsibility falls upon the Auditor; and where such failure is due to lack of supervision on the part of the Auditor, in allowing the details of the Audit to be carried out in a mechanical way by his clerks, he must suffer the consequences. (*The Irish Woollen Company, Ltd., v. Tyson & Others, supra.*)

(b) Liability for Misfeasance.

The term "Misfeasance" implies a breach of duty. The Auditor of a Company, therefore, commits a misfeasance if he is negligent in the performance of his duties as Auditor, but he cannot be made liable in damages under s 215 of the Companies (Consolidation) Act, 1908, in the event of winding-up, unless such misfeasance has directly resulted in damage to the Company. It is possible to conceive negligence on the part of the Auditor, resulting in damage of various kinds to a Company, but in the majority of cases the damage takes the form of the improper payment of Dividends out of Capital, which would not have been paid had the Auditor not committed a misfeasance.

The two principal cases on the subject have been taken on the question of dividends, and are known as *In re the London & General Bank*, No. 2 (*supra*), and *In re the Kingston Cotton Mill Co., Ltd.*, No. 2 (*supra*): In the first case the Auditor was held liable by the Court of Appeal; in the second case he was not.

The most important passages in the judgments have been printed in the preceding section, and from a perusal thereof it is possible to arrive at the general principles which the Court of Appeal consider should be followed by the Auditor in the performance of his duties.

In the *London and General Bank* case it was proved that the Auditor was aware of the serious position of the Company, owing to the fact that large sums advanced to customers on Loans and Current Account were insufficiently secured, and he was also aware that interest on such advances was taken to the credit of the Profit and Loss Account, although such interest had not been paid or reserved against. He reported upon this state of affairs to the Directors, but failed to induce them to make the necessary alterations in the Accounts, or to refrain from paying a dividend. Lindley, L.J., said that taking the Balance Sheet, Certificate, and Report together, the Auditor stated the true financial position of the Bank to the Directors, and if this Report had been laid before the Shareholders he would have completely discharged his duty to them. The misfeasance in this instance consisted in not placing this information before the Shareholders. It was pointed out by the learned Judge that information, and means of information, are not equivalent terms, and that a person whose duty it is to convey information to others does not discharge that duty by simply giving them so much information as is calculated to induce them, or some of them, to ask for more. An Auditor who adopts such a course as this does so at his peril, and runs a very serious risk of being held judicially to have failed to discharge his duty.

It should be remembered that this decision was given before there was any direct statutory

authority under which the Auditor's Report could be made to the Shareholders privately, without being published with the Accounts. It was then sometimes a very difficult matter for the Auditor to decide what he should do. If the circumstances were such that the publication of a full Report would be detrimental to the Company's interests, as it certainly would be in the case of a Bank where the Report was unfavourable, he had to choose between taking this course, and possibly damaging the credit of the Bank irretrievably, or signing a Report or Certificate conveying little or no information, and running the risk of being held liable for misfeasance. The present law provides machinery whereby the Auditor can escape from this difficult position, since his Report need not be published with the Balance Sheet. It is clearly the Auditor's duty, therefore, in cases where the Balance Sheet is not in order, to report fully to the Shareholders. It will then remain for the Directors to decide whether to publish such Report or not, and the Auditor will be entirely free from responsibility in the matter.

The Auditor is not concerned whether the business of the Company is prudently or imprudently conducted, and it is no part of his duty to give advice either to Directors or to Shareholders. Whether dividends are properly or improperly declared, is immaterial to the Auditor, provided he discharges his own duty to the Shareholders.

The Auditor's duty is not merely confined to verifying the arithmetical correctness of the Balance Sheet, and comparing it with the books. He must make proper enquiries to see that the books of the Company themselves show the true position; at the same time, he is not bound to do more than exercise

reasonable care and skill. He is not an insurer ; he does not guarantee that the books do correctly show the true position of the Company's affairs ; neither does he guarantee that the Balance Sheet is accurate, according to the books. The Auditor must be honest, that is, he must not certify what he does not believe to be true, and he must take reasonable care and skill before he believes that what he certifies is true.

The case of *In re the Kingston Cotton Mill Co., Ltd.*, No. 2 (*supra*), makes it clear that in the absence of suspicious circumstances the Auditor is not liable for the correctness of the Stock-in-Trade appearing in the Balance Sheet. In that case the Stock-in-Trade had been deliberately manipulated, and the Auditors accepted the certificate of the Manager as to the correctness thereof, without checking the stock in detail. The Court of Appeal held that they were not guilty of negligence in so doing ; that it is not the duty of the Auditor to take stock, but that he is entitled to rely upon other people for details of this nature. In the absence of suspicious circumstances, the Auditor can rely upon the representations of trusted officials ; he is justified in believing tried servants of the Company, in whom confidence is placed by the Company.

Lopes, L.J., said that Auditors must not be held liable for not tracking ingenious and carefully-laid schemes of fraud, when there is nothing to arouse their suspicion, and when those frauds are perpetrated by tried servants of the Company, and are undetected for years by the Directors.

This decision is valuable, as defining, to some extent, the liability of the Auditor, but it should be observed that the question as to whether or not the Auditor may be held to have been negligent, will depend entirely

upon the circumstances in each case; that this is so is confirmed by the decision in *Henry Squire (Cash Chemists, Limited) v. Ball, Baker & Co. and Mead, v. Same* (44, Acct. L. R. 25).

It was shown in the course of this case that Stock Sheets had been falsified for years, and that they contained numerous alterations, which, it was argued, should have caused suspicion. It was held that the Auditors had relied upon the certificate of a responsible official, and their suspicions had not been aroused in the course of their investigations, and that in the given circumstances there was nothing necessarily to arouse the suspicions of an Auditor who had exercised the skill necessary in conducting the audit.

It has already been pointed out in Chapter V., § 4 (c), that the Auditor's duty in relation to Stock-in-Trade should not be confined to ascertaining that the Stock Sheets are duly certified by some responsible official, but that he should test the accuracy of the details as far as may be reasonable.

It is the duty of an Auditor of a Limited Company to make himself acquainted with his duties under the Articles of the Company and under the Companies Acts for the time being in force, and this particularly applies to the passing of payments made by the Directors *ultra vires*.

Where such payments have been made the Auditor must be particularly careful to refer to them in his report to the Shareholders, since if this is not done it might be held that the Company had suffered loss by reason of not having been able to recover the amounts improperly paid away.

In the case of *In re Bolivia Exploration Syndicate* (1900, 24 T. L. R. 450), where circumstances of the

nature arose, but where the Auditors had pointed out the facts or they had been disclosed on the face of the Accounts, it was held that damage to the Company had not been established and that the Auditors had not been guilty of any breach of duty.

In conclusion, it may be said that the measure of an Auditor's liability in any particular case will depend upon the skill and diligence with which he has performed his duties. The Auditor who exercises reasonable care and skill, whether in performing the work himself, or by delegation to his clerks, or in accepting representations of trusted officials, should not find himself subject to any liability.

SYNOPSIS OF CHAPTER XIII.

The Audit of Partnership Accounts.

§ 1.—THE PARTNERSHIP ACT, 1890

2.—PARTNERSHIP DEEDS.

3.—THE ADJUSTMENT OF THE RIGHTS OF PARTNERS *inter se*—

- (a) Interest on Capital.
- (b) Partners' Salaries.
- (c) Partners' Drawings
- (d) The Adjustment of Income Tax.

4.—THE LIMITED PARTNERSHIPS ACT, 1907

5.—AUDIT ON BEHALF OF AN INDIVIDUAL PARTNER OR CREDITORS—

- (a) Audit on behalf of a Limited Partner.
- (b) Audit on behalf of a Sleeping Partner.
- (c) Audit on behalf of a Retired Partner.
- (d) Audit on behalf of the Representatives of a Deceased Partner.
- (e) Audit on behalf of Creditors.

CHAPTER XIII.

THE AUDIT OF PARTNERSHIP ACCOUNTS.

§ 1.—The Partnership Act, 1890.

Partnership, as defined by the Partnership Act, 1890 is the relation which exists between persons carrying on a business in common, with a view to profit. This Act codified the Law of Partnership, and applies in all cases so far as the rights of the Partners *inter se* are concerned except where by a Deed of Partnership or by mutual arrangement other provisions are made.

The following are the most important Sections from the Auditor's point of view.

21. Unless the contrary intention appears, property bought with money belonging to the firm is deemed to have been bought on account of the firm.

24. The interests of partners in the partnership property and their rights and duties in relation to the partnership shall be determined subject to any agreement, express or implied, between the partners by the following rules:—

(1) All the partners are entitled to share equally in the capital and profits of the business, and must contribute equally towards the losses, whether of capital or otherwise, sustained by the firm.

(2) The firm must indemnify every partner in respect of payments made and personal liabilities incurred by him—

(a) in the ordinary and proper conduct of the business of the firm; or

(b) in or about anything necessarily done for the preservation of the business or property of the firm.

(3) Nothing done by a partner for the purpose of the partnership, or in or about anything necessarily done for the preservation of the business or property of the firm, shall be deemed to be a loan to the partner.

which he has agreed to subscribe, is entitled to interest at the rate of 5 per cent. per annum from the date of the payment or advance.

- (4) A partner is not entitled, before the ascertainment of profits, to interest on the capital subscribed by him.
- (5) Every partner may take part in the management of the partnership business.
- (6) No partner shall be entitled to remuneration for acting in the partnership business.
- (7) No person may be introduced as a partner without the consent of all existing partners.
- (8) Any difference arising as to ordinary matters connected with the partnership business may be decided by a majority of the partners, but no change may be made in the nature of the partnership business without the consent of all existing partners.
- (9) The partnership books are to be kept at the place of business of the partnership (or the principal place, if there is more than one), and every partner may, when he thinks fit, have access to and inspect and copy any of them.

28. Partners are bound to render true accounts and full information of all things affecting the partnership to any partner or his legal representatives.

29.—(1) Every partner must account to the firm for any benefit derived by him without the consent of the other partners from any transaction concerning the partnership, or from any use by him of the partnership property, name, or business connection.

(2) This section applies also to transactions undertaken after a partnership has been dissolved by the death of a partner, and before the affairs thereof have been completely wound up, either by any surviving partner or by the representatives of the deceased partner.

39. On the dissolution of a partnership, every partner is entitled as against the other partners in the firm, and all persons claiming through them in respect of their interests as partners, to have the property of the partnership applied in payment of the debts and liabilities of the firm, and to have the surplus assets, after such payment, applied in payment of what may be due to the partners respectively, after deducting what may be due from them as partners to the firm; and for that purpose any partner or his representatives may, on the termination of the partnership, apply to the court to wind up the business and affairs of the firm.

40. Where one partner has paid a premium to another on entering into a partnership for a fixed term, and the partnership is dissolved before the expiration of that term otherwise than by the death of a partner, the court may order the repayment of the premium, or of

such part thereof as it thinks just, having regard to the terms of the partnership contract, and to the length of time during which the partnership has continued, unless—

- (a) the dissolution is, in the judgment of the court, wholly or chiefly due to the misconduct of the partner who paid the premium, or,
- (b) the partnership has been dissolved by an agreement containing no provision for a return of any part of the premium.

42—(1) Where any member of a firm has died, or otherwise ceased to be a partner, and the surviving or continuing partners carry on the business of the firm, with its capital or assets, without any final settlement of accounts as between the firm and the outgoing partner or his estate, then, in the absence of any agreement to the contrary, the outgoing partner or his estate is entitled at the option of himself or his representatives to such share of the profits made since the dissolution as the court may find to be attributable to the use of his share of the partnership assets, or to interest at the rate of 5 per centum per annum on the amount of his share of the partnership assets.

(2) Provided that where by the partnership contract an option is given to surviving or continuing partners to purchase the interest of the deceased or outgoing partner, and that option is duly exercised, the estate of the deceased partner or the outgoing partner, or his estate, as the case may be, is not entitled to any further or other share of profits, but if any partner, assuming to act in exercise of the option, does not in all material respects comply with the terms thereof, he is liable to account under the foregoing provisions of this section.

43 Subject to any agreement between the partners, the amount due from surviving or continuing partners to an outgoing partner, or the representative of a deceased partner, in respect of the outgoing or deceased partner's share, is a debt accruing at the date of the dissolution or death.

44. In settling accounts between the partners after a dissolution of partnership, the following rules shall, subject to any agreement, be observed —

- (a) Losses, including losses and deficiencies of capital, shall be paid first out of profits, next out of capital, and lastly, if necessary, by the partners individually, in the proportion in which they were entitled to share profits;
- (b) The assets of the firm, including the sums (if any) contributed by the partners to make up losses or deficiencies of capital, shall be applied in the following manner and order:—
 - (1) In paying the debts and liabilities of the firm to persons who are not partners therein;
 - (2) In paying to each partner rateably what is due from the firm to him for advances as distinguished from capital.

- (3) In paying to each partner rateably what is due from the firm to him in respect of capital ;
- (4) The ultimate residue (if any) shall be divided among the partners in the proportion in which profits are divisible.

§ 2.—Partnership Deeds.

It has already been pointed out in Chapter I., § 4 (b), that the Audit of Partnership Accounts is not performed under Statute, but under the Deed of Partnership, or by mutual agreement between the Partners, and that the Auditor's duties consequently depend upon the instructions he receives from his clients.

The importance of the Auditor's duties being defined in writing was there pointed out, since in the case of private firms Auditors frequently perform Accountancy work in addition to Audit work proper; or, on the other hand, they may not be required to undertake the whole of the work that would be necessary were a complete Audit carried out. In Chapter XII., § 4 (a), the Auditor's liability in this connection is discussed.

On taking up a Partnership Audit, the Auditor should ask for the Deed of Partnership. If there is no deed or written agreement, he should obtain in writing a statement of any arrangements mutually agreed upon by the Partners, differing from the provisions of the Partnership Act, 1890.

The Deed of Partnership should be particularly examined with reference to the following points :—

- (1) As to Capital, and whether each Partner contributes a fixed amount or otherwise.
- (2) As to the division of Profits and Losses, including Capital Profits and Losses.
- (3) Whether the Capitals are fixed, Drawings and Profits being adjusted in Current Accounts.

whether same are to be adjusted in the Capital Accounts.

- (4) Whether Interest on Capital or Drawings, or both, is chargeable, and the rate thereof.
- (5) Whether Partners' Current Accounts (if any) are to bear interest, and the rate thereof.
- (6) Whether Drawings in advance of Profits are permitted, and if so, with what limitations.
- (7) As to Partners' Salaries (if any).
- (8) Clauses as to the preparation of Accounts: whether the same are to be audited, and signed by the Partners, and whether such signatures shall bind the Partners.
- (9) The method (if any) of determining the amount of goodwill in the event of the death of any one of the Partners.
- (10) Provision as to the taking of accounts at the death of any Partner.
- (11) Provision as to the treatment of Partnership Insurance Policies (if any).

§ 3.—The Adjustment of the Rights of Partners *inter se*.

One of the most important of the Auditor's duties in connection with Partnership Accounts is to see that the rights of the several partners *inter se* have been properly adjusted in accordance with the terms of the Deed, or mutual arrangement.

As to how far the authority of one Partner (even though he be the senior Partner of the firm) is sufficient for the purpose of the Auditor acting on behalf of the firm as a whole, is a somewhat difficult matter to decide, particularly where the instructions given affect the

rights of the other Partners. In such a case the Auditor must use his own discretion as to whether he is justified in accepting verbal instructions, unless they are confirmed in writing by all the Partners, since one Partner cannot be regarded as the Agent of the firm for such a matter. This consideration may particularly arise where there are disputes between one or more of the Partners, or where one Partner has been acting improperly, or in contravention of the terms of the Deed.

The more usual adjustments in Partnership Accounts will now be considered.

(a) Interest on Capital.

Unless provided for in the Deed of Partnership, or by mutual agreement, Interest on Capital is not chargeable. In cases where the Capitals of the Partners are not in the same ratio as that in which they share Profits or Losses, it is usually agreed to charge Interest on Capital at the rate of 5 per cent. per annum.

Where the Capital Accounts are fixed, interest will be charged on such amounts, and will not apply to the accumulation of undrawn profits, unless it is mutually agreed that this should be so. Sometimes such accumulations bear interest at a lower rate than on the Capital employed. Interest should be calculated on the opening balance of Capital from date of the last account, subject to any necessary adjustment in respect of Capital paid in or withdrawn during the period.

Where Partners have made advances to the firm, or introduced more Capital than originally agreed upon, they are entitled to interest thereon at 5 per cent. per annum, even though they may not be entitled to Interest on Capital.

(b) Partners' Salaries.

Salaries are sometimes payable to one or more of the Partners, either in lieu of a share of the profits or in addition thereto. This principle is frequently adopted in connection with a junior Partner, or where one or more of the Partners leave the larger share of the management of the business to a remaining Partner or Partners.

Any Partners' Salaries agreed upon should be charged to the Profit and Loss Account, before the Profits are divided between the Partners.

(c) Partners' Drawings.

The Auditor should vouch Partners' Drawings on account of profit with the returned cheques, and should ascertain that the amounts withdrawn are in accordance with the limitations imposed by the Deed of Partnership (if any), or by mutual agreement. In some cases it is usual for Partners to utilise their Drawing Account as a means of discharging private expenditure, and in such a case the actual Drawings will be somewhat more difficult to vouch, as the vouchers will usually be retained by the Partner as affecting his private affairs; while the inspection of the returned cheques will not afford much evidence that the item should be charged to the Partners' Account.

Cases have been known where Partners' Drawing Accounts have been utilised for the purpose of concealing fraud, either on the part of an employé or on the part of another Partner. This has been effected by means of improperly charging items to a Partner's Account, and as many Partners make no attempt to check their own Drawing or Current Accounts, such manipulation might easily pass unnoticed for some

time. It is important, therefore, that the Auditor should obtain sufficient evidence that the Drawings are in order ; and, if this is not forthcoming, he should suggest that the Partners should initial their Drawing Accounts in the Ledger, as having agreed the same.

Where Partners' Drawings are irregular, provision may be made to charge Interest thereon, commonly at a lower rate than Interest on Capital. The calculation of the Interest should be made from the date of each Drawing to the date of the Account.

(d) The Adjustment of Income Tax.

The assessment to Income Tax is made on the firm as a whole ; but provision is made whereby a Partner can claim any exemption, relief or abatement, to which he may be entitled, provided he makes the necessary Return in support of his claim.

If the Income Tax Return made on behalf of the firm is properly filled up, and all the relief and allowances claimed to which any Partner may be individually entitled, whether in the shape of exemption, abatement, relief in respect of earned income, or allowance for Life Insurance Premiums, the actual assessment ultimately made upon the firm may be divided as between tax payable at the higher and lower rates respectively. The allocation of the amount so payable by the firm, as between the various Partners, is a matter of material consequence, and the Auditor should ascertain that this has been correctly done.

The practical difficulties involved in the proper adjustment of Partnership Income Tax under all but the most simple conditions are considerable. It is not within the scope of the present volume to deal further

with this subject, which is fully discussed and illustrated in the Authors' volume on *Income Tax in Relation to Accounts*.

Similar remarks apply to the preparation of Accounts for the purpose of the returns of individual partners for Super Tax.

§ 4.—The Limited Partnerships Act, 1907.

The Limited Partnerships Act, 1907, came into operation the first day of January, 1908, and established for the first time the principle of Limited Partnerships.

• The following are the most important sections from the Auditor's point of view :—

4. - (1) From and after the commencement of this Act limited partnerships may be formed in the manner and subject to the conditions by this Act provided.

(2) A limited partnership shall not consist, in the case of a partnership carrying on the business of banking, of more than ten persons, and, in the case of any other partnership, of more than twenty persons, and must consist of one or more persons called general partners, who shall be liable for all debts and obligations of the firm, and one or more persons to be called limited partners, who shall at the time of entering into such partnership contribute thereto a sum or sums as capital or property valued at a stated amount, and who shall not be liable for the debts or obligations of the firm beyond the amount so contributed.

(3) A limited partner shall not during the continuance of the partnership, either directly or indirectly, draw out or receive back any part of his contribution, and if he does so draw out or receive back any such part shall be liable for the debts and obligations of the firm up to the amount so drawn out or received back.

(4) A body corporate may be a limited partner.

• 5. Every limited partnership must be registered as such in accordance with the provisions of this Act, or in default thereof it shall be deemed to be a general partnership, and every limited partner shall be deemed to be a general partner.

6.—(1) A limited partner shall not take part in the management of the partnership business, and shall not have power to bind the firm :

Provided that a limited partner may by himself or his agent at any time inspect the books of the firm and examine into the state and prospects of the partnership business, and may advise with the partners thereon.

If a limited partner takes part in the management of the partnership business he shall be liable for all debts and obligations of the firm incurred while he so takes part in the management as though he were a general partner.

(2) A limited partnership shall not be dissolved by the death or bankruptcy of a limited partner, and the lunacy of a limited partner shall not be a ground for dissolution of the partnership by the court unless the lunatic's share cannot be otherwise ascertained and realised.

(3) In the event of the dissolution of a limited partnership its affairs shall be wound up by the general partners unless the court otherwise orders.

(5) Subject to any agreement expressed or implied between the partners—

- (a) Any difference arising as to ordinary matters connected with the partnership business may be decided by a majority of the general partners ;
- (b) A limited partner may, with the consent of the general partners, assign his share in the partnership, and upon such an assignment the assignee shall become a limited partner with all the rights of the assignor ;
- (c) The other partners shall not be entitled to dissolve the partnership by reason of any limited partner suffering his share to be charged for his separate debt ;
- (d) A person may be introduced as a partner without the consent of the existing limited partners ;
- (e) A limited partner shall not be entitled to dissolve the partnership by notice.

7. Subject to the provisions of this Act, the Partnership Act, 1890, and the rules of equity and of common law applicable to partnerships, except so far as they are inconsistent with the express provisions of the last-mentioned Act, shall apply to limited partnerships,

Section 24 of the Bankruptcy and Deeds of Arrangement Act, 1913, provides that Limited Partnerships are to be wound up in Bankruptcy, instead of under the Companies Acts as formerly.

§ 5.—Audit on behalf of an Individual Partner or Creditors.

In certain instances an Auditor is appointed to act for an Individual Partner, or for a Creditor. Where this is so, the Auditor should ascertain that the precise limits of his responsibility are defined. Where he is appointed at the instance of one Partner, or of a Creditor, but his remuneration is paid by the firm, he may be acting jointly in the interests of all parties, unless the contrary is clearly expressed.

Instances in which Audits of this nature may take place, and the special points to which the Auditor should direct his attention, assuming him to be acting solely for the individual appointing him, will now be considered.

•
(a) Audit on behalf of a Limited Partner.

Under § 6 of the Limited Partnerships Act, 1907, a Limited Partner may by his Agent at any time inspect the books of the firm, and examine into the state and prospects of the Partnership business. This clause gives the Limited Partner power to appoint an Auditor on his behalf.

In such a case the Auditor would pay particular attention to certain points in addition to the ordinary work involved in an Audit of the business concerned.

It should be seen that the profits as shown by the Profit and Loss Account are not understated by reason of excessive reserves, or unnecessary provision for depreciation; and that profits are not charged with items of a Capital nature, since in either of these cases the effect would be to reduce the share of profit to be credited to the Limited Partner, and he might altogether lose the benefit of profits so applied, in the event of

the repayment of his Capital at the conclusion of the Partnership.

It should be seen that all the requirements of the Limited Partnerships Act, 1907, have been complied with, and that the Limited Partnership is duly registered with the Registrar of Joint Stock Companies, as if this has not been done the Limited Partner will be regarded as a General Partner, and will be liable accordingly.

It should be seen that the General Partners do not overdraw in respect of either Profits or Capital in excess of the powers contained in the Deed of Partnership.

The Auditor must utilise his own discretion as to the extent of his examination, and will not be able to accept any instructions from the General Partners as to limitation of his investigation.

• (b) Audit on behalf of a Sleeping Partner.

The term " Sleeping Partner " is applied to a Partner when he retires from active participation in the business, but retains his capital therein, and probably a reduced share of profits.

Such a Partner may desire to appoint an Auditor on his behalf, when similar points would arise in the course of the Audit as have been dealt with in the preceding paragraph, except in so far as the remarks there apply specifically to Limited Partnerships.

As the liability of such a Partner is unlimited, and he is not concerned in the active management of the business, the Auditor appointed on his behalf should report to him on any transactions of a nature to affect his interests, especially where transactions are entered into of a speculative character, which do not form part of the ordinary business of the firm.

(c) Audit on behalf of a Retired Partner.

On the occasion of the retirement of a Partner, where a firm have not previously employed Auditors, an Auditor may be appointed for the purpose of examining the Accounts, and ascertaining that the rights of the Partners *inter se*, and particularly the rights of the retiring Partner, are properly adjusted. In such a case he should take care to ascertain whether he is acting for the firm as a whole, or merely for the retiring Partner.

It should be seen that the provisions of the Partnership Deed relating to the retirement of a Partner have been complied with, and that the whole of the firm's assets are brought into account at a proper valuation.

It should also be ascertained that all outstanding assets and liabilities have been included, in order that the final balance of Profit and Capital due to the retiring Partner may be accurately ascertained.

A retiring Partner may wish to determine his liability, but at the same time to leave the whole or some portion of his Capital in the business, taking advantage of sub-section 3 (d) of § 2 of the Partnership Act, 1890. The Capital so remaining becomes then a loan to the Partnership, the retiring Partner receiving interest thereon varying with the profits.

Such an individual is sometimes termed a "Quasi" Partner, but is in effect simply a Deferred Creditor, his loan not being repayable until all the outside creditors of the firm are paid in full, unless the same is secured. There must be an Agreement in writing between the parties, which should be examined by the Auditor, and it should be seen that the balance to the credit of the retiring Partner's Capital Account is transferred to a Loan Account, and that the interest

payable to him, based on a proportion of the profits, is treated as an expense of the business, and not as an appropriation of profits.

As the interest takes this form, the Auditor must ascertain that the Profit and Loss Account is correct, and similar considerations apply in respect of Reserves, Depreciation, &c., as have been already mentioned in the case of a Limited Partner.

Where the retiring Partner leaves his Capital in the business at a fixed rate of interest, either for a term of years or to be repaid by annual instalments, he is merely in the position of a Creditor, but he may appoint an Auditor to act on his behalf while the firm remains indebted to him.

The duties of an Auditor in such a case will be mainly confined to ascertaining the financial position of the firm, in order that the retired Partner may take the necessary steps if his interest become in any way endangered by losses being incurred.

(d) Audit on behalf of the Representatives of a Deceased Partner.

In some cases provision is made by a Deed of Partnership for the Capital of a Deceased Partner to be retained in the business for a period of years, or to be repaid over a period of years, subject to interest at a fixed rate per cent., and where this is the case the Executors may desire to appoint an Auditor for the purpose of protecting their interests.

The special duties of such an Auditor are similar to those already dealt with in the case of an Auditor acting on behalf of a retired Partner.

Where the representatives of the Deceased Partner are entitled to payment of a sum in respect of Goodwill,

it will be the duty of the Auditor appointed by them to verify the correctness of the amount so payable.

If the Deed contains precise instructions as to how the amount is to be arrived at, and particularly where the signed accounts are to form the basis of the calculation, few points of difference may arise, but in other cases the Auditor may have to go carefully into the previous accounts, in order to ascertain that no charges have been made against the Profit and Loss Account which detrimentally affect the rights of the Deceased Partner.

The amount payable in respect of Goodwill may take the form of the payment of a proportion of the profits to the legal personal representatives over a term of years. The Auditor appointed on their behalf in such a case will be mainly concerned with ascertaining that the Profit and Loss Accounts for the years in question are prepared on a correct basis, and that no excessive or secret reserves have been made.

(c) **Audit on behalf of Creditors.**

Where a firm have made an arrangement with their Creditors, an Auditor is sometimes appointed to audit the accounts of the firm on behalf of the Creditors, until the liabilities are completely discharged.

The special points to which an Auditor in such a case should direct his attention would vary according to the particular circumstances of the trade and the instructions of his clients; but generally speaking, it may be said that he should ascertain that the profits are correctly arrived at, and that the Drawings of the Partners are not in excess of any limitation imposed by the Creditors.

The duties of an Auditor appointed on behalf of a Creditor who has lent money to the business would be of a similar nature. If any specific limitations as to drawings, or the conduct of the business, have been entered into between the lender and the firm, he should see that these have been adhered to, and, generally speaking, his examination will be of such a nature as will enable him to report to his client as to the state of the affairs of the business, so that the latter can ascertain whether the conditions of the loan have been complied with, and decide whether it shall be continued.

SYNOPSIS OF CHAPTER XIV.

Other Statutes affecting Auditors.

§ 1.—THE COMPANIES CLAUSES CONSOLIDATION ACT, 1845.

2.—RAILWAY COMPANIES ACTS.

3.—GAS AND WATER COMPANIES ACTS.

4.—ELECTRIC LIGHTING COMPANIES ACTS.

5.—THE ASSURANCE COMPANIES ACT, 1909.

6.—BUILDING SOCIETIES ACTS.

7.—FRIENDLY SOCIETIES ACTS.

8.—INDUSTRIAL AND PROVIDENT SOCIETIES ACTS.

9.—TRUSTEE SAVINGS BANKS ACTS.

10.—EXECUTORS' AND TRUSTEES' ACCOUNTS—

(a) The Public Trustee Act, 1906.

(b) The Judicial Trustees Act, 1896.

11.—MISCELLANEOUS STATUTES—

(a) The Licensing Act, 1904.

(b) Territorial and Reserve Forces Act, 1907.

(c) The Port of London Act, 1908.

CHAPTER XIV.

OTHER STATUTES AFFECTING AUDITORS.

The Statute Law affecting Limited Companies as embodied in the Companies (Consolidation) Act, 1908, and that affecting Partnerships as embodied in the Partnership Act, 1890, and the Limited Partnerships Act, 1907, have been separately dealt with in preceding chapters owing to their general importance.

There remain, however, a number of other statutes affecting different classes of Audits with which the Auditor of such concerns should be familiar before entering upon his duties. The various sections of such statutes that are of importance to Auditors, and the forms of Account prescribed in certain instances, will be found printed in the Appendix.

In this chapter it is intended to summarise the clauses of the principal Acts relating to the appointment and duties of Auditors and the Accounts of various undertakings concerned.

§ 1.--The Companies Clauses Consolidation Act, 1845.

The phrase "Parliamentary Companies" is applied to Companies incorporated by a special Act for the purpose of carrying on any undertaking for which special powers are necessary. In such cases the special Act must incorporate the Companies Clauses Consolidation Act, 1845. Railway, Gas, Electric Light, Water, and other concerns of a similar nature come under this heading.

Under this Act the following books are compulsory :—

- (1) Register of Shareholders (§ 9).
- (2) Shareholders' Address Book (§ 10).
- (3) Register of Mortgages and Bonds (§ 45).
- (4) Register of Holders of Consolidated Stock (§ 63).
- (5) Minute Book (§ 98).

The appointment and duties of Auditors are dealt with in §§ 101-108. Except where the special Act provides otherwise two Auditors must be appointed, who retire alternately each year. Each Auditor must hold at least one share in the undertaking, but this has been repealed as far as railways are concerned by the Regulation of Railways Act, 1868.

The Directors must deliver to the Auditors the half-yearly or other periodical accounts and Balance Sheet, and the Auditors must examine the same, and either make a special report on the said accounts, or confirm them. The Auditors have power to employ such Accountants and other persons as they may think proper at the expense of the Company.

The Accounts to be kept by the Company and submitted to the Shareholders are dealt with in §§ 115-119, while §§ 120-123 relate to Dividends.

The Companies Clauses Acts, 1863, and 1869, amend the Companies Clauses Consolidation Act, 1845, in some particulars, and contain further provisions applicable to Companies incorporating that Act.

§ 2.—Railway Companies Acts.

• Railway Companies are subject to the Railway Companies Act, 1867, the Regulation of Railways Act, 1868, the Railway Companies (Accounts and Returns)

Act, 1911, and other Acts in addition to the Companies Clauses Acts, and their Special Acts.

Section 30 of the Railway Companies Act, 1867, as amended by § 4 of the Railway Companies (Accounts and Returns) Act, 1911, refers to the Audit of railway accounts, and provides that no Dividends shall be declared until the Auditors have certified that the yearly accounts proposed to be issued, contain a full and true statement of the financial position of the Company, and that the Dividend proposed to be declared on any shares is *bonâ fide* due thereon after charging the Revenue of the year with all expenses which ought to be paid the out in the judgment of the Auditors.

Provision is made for dealing with any difference of opinion between the Directors and the Auditors, and the powers of the Auditors with reference to the examination of books are set out.

Under § 4 of the Railway Companies (Accounts and Returns) Act, 1911, a Railway Company shall not be under any obligation to prepare or submit to the Shareholders or Auditors statements of accounts or Balance Sheets, or hold Ordinary General Meetings more than once a year except where the Company is under an obligation to prepare half-yearly accounts in cases where those accounts are required in connection with any guarantee of dividend

Under the same section the Directors may, if it appears to them that the profits of the Company are sufficient, declare and pay an interim dividend for the first half of the year, notwithstanding that the accounts are not audited for the half-year, and that a statement of accounts and Balance Sheet for the half-year are not submitted to the Shareholders.

Under § 12 of the Regulation of Railways Act, 1868, the Board of Trade may appoint an Auditor in addition to the Auditors of the Company, who shall have the same duties and powers as the Auditors of the Company, and shall report to the Company.

Where, in consequence of such appointment, there are three or more Auditors, the Company may declare a dividend if the majority of the Auditors certify in accordance with the provisions of § 30 of the Railway Companies Act, 1867, but the dissenting Auditor or Auditors must issue to the Shareholders a statement setting forth the grounds on which he differs from his colleagues, and affording such information as he thinks material to the Shareholders.

The Railway Companies (Accounts and Returns) Act, 1911, provides for uniform Accounts and Returns to be kept by every Railway Company according to the forms contained in the Schedule to the Act, which will be found in the Appendix.

§ 3. Gas and Water Companies Acts.

In addition to their special Acts, the Companies (Clauses Consolidation Act, 1845, and other Acts, Gas Companies are subject to the Gas Works (Clauses Acts, 1847, and 1871; while Water Companies are subject to the Waterworks (Clauses Act, 1847.

No special provisions as to the appointment of Auditors apply in either case.

Metropolitan Gas Companies are subject to audit by an Auditor appointed by the Board of Trade.

• Under § 35 of the Gas Works Clauses Act, 1871, certain statutory forms of Account are specified, which will be found printed in the Appendix.

There is no specified form of Accounts in the case of Water Companies.

§ 4.—Electric Lighting Companies Acts.

A concession for Electric Lighting may be obtained either by a Company formed under special Act, or by Board of Trade Licence or Order, granted to a Company under the Companies Acts, or to an individual, or a Local Authority. Electric Lighting Companies are subject to the Electric Lighting Acts, 1882, 1888 and 1899, with the Board of Trade Rules thereunder.

In addition to the Auditors appointed on behalf of the Shareholders, the Electric Lighting Clauses Act, 1899, provides that the Accounts of any concern working under a Provisional Order made by the Board of Trade where the undertakers are not a Local Authority, shall, before being published, be audited by an Auditor appointed by the Board of Trade. The remuneration of the Auditor shall be such as the Board of Trade direct, and shall be paid by the Company.

Such an Auditor is appointed by the Board of Trade to protect the interests of consumers, and the Board of Trade have stated that they hold it to be outside the province of this Auditor to act as Auditor on behalf of the Shareholders.

Under § 9 of the Electric Lighting Act, 1882, statutory forms of Account are required which are printed in the Appendix.

§ 5.—The Assurance Companies Act, 1909.

The Assurance Companies Act, 1909, applies to all persons or bodies of persons, whether corporate or unincorporate, not being registered under the Acts

relating to Friendly Societies or to Trade Unions, carrying on within the United Kingdom the following classes of business: (a) Life Insurance; (b) Fire Insurance; (c) Accident Insurance; (d) Employers' Liability Insurance; (e) Bond Investment Business.

Under § 9 where the Accounts of an Assurance Company are not subject to Audit in accordance with the provisions of the Companies (Consolidation) Act 1908, or the Companies Clauses (Consolidation) Act, 1845, the Accounts of the Company shall be audited annually in such manner as the Board of Trade may prescribe.

Under § 4 every Assurance Company must prepare at the end of each financial year a Revenue Account and Profit and Loss Account and a Balance Sheet in the prescribed forms, which will be found in the Appendix.

§ 6.—Building Societies Acts.

Under § 16 of the Building Societies Act, 1874, it was provided that the rules of every Society should provide for an annual or more frequent Audit of the Accounts; and for inspection by the Auditors of the Mortgages and other Securities belonging to the Society.

Under § 3 of the Building Societies Act, 1894, it is provided that notwithstanding anything in the rules of any Society, one at least of the Auditors must be a person who publicly carries on the business of an Accountant.

Section 2 of the same Act provides that every Auditor in passing any annual account or statement must either certify that it is correct, duly vouched, and in accordance with law, or specially report to

the Society in what respect he finds it incorrect, unvouched, or not in accordance with law, and must also certify that he has at that Audit actually inspected the Mortgage Deeds, and other Securities belonging to the Society, and must state the particular properties in respect of which deeds have been produced to, and actually inspected by him.

Under the same Section every annual Account and Statement must be made up in such form, and contain such particulars as the Chief Registrar of Friendly Societies may from time to time direct. The Section sets out particulars which the form must disclose, and the form will be found printed in the Appendix.

§ 7.—Friendly Societies Acts.

Under § 26 of the Friendly Societies Act, 1896, every registered Society and Branch shall once at least in every year submit its accounts for audit either to a Public Auditor or to two or more persons appointed as the rules of the Society or Branch provide.

The Auditors shall have access to all the books and accounts of the Society or Branch, and shall examine the Annual Return mentioned in the Act, and verify the Annual Return with the accounts and vouchers relating thereto, and shall either sign the Annual Return as found by them to be correct, duly vouched and in accordance with law, or specially report to the Society or Branch in what respect they find it incorrect, unvouched, or not in accordance with law.

The Public Auditors above mentioned are appointed the Treasury, and their remuneration is fixed by

the Treasury, but the employment of these Auditors is not compulsory, and in many cases the Societies prefer to have their accounts audited by their own members.

Any person desiring to be appointed a Public Auditor must write to the Parliamentary Secretary of the Treasury, 12, Downing Street, Whitehall, S.W., asking to be appointed and stating: (a) his full name; (b) his address; (c) his professional qualifications as an Accountant; (d) his experience as Auditor of Societies; (e) reason for thinking that the appointment of Public Auditor in the district where he resides is desirable in the public interest.

The conditions under which Public Auditors hold their appointments, and the scale of remuneration will be found in the Appendix.

Under § 6 of the Collecting Societies and Industrial Assurance Companies Act, 1896, the Annual Return required to be sent to the Registrar, under the Friendly Societies Act, 1896, must, in the case of a Collecting Society, have been certified by a Public Accountant.

Under § 27 of the Friendly Societies Act, 1896, every Registered Society or Branch must send to the Registrar of Friendly Societies a Return of the receipts and expenditure, funds and effects of the Society or Branch as audited, the form of which will be found in the Appendix.

§ 8.—Industrial and Provident Societies Acts.

• • The Audit of Industrial and Provident Societies is governed by § 13 of the Industrial and Provident Societies Act, 1893, as amended by the Industrial and

Provident Societies (Amendment) Act, 1913. Under § 2 of the 1913 Act every Registered Society shall once in every year submit its accounts for audit to one or more of the Public Auditors appointed under the provisions of the principal Act. No Auditor shall hold any other office in connection with the Society.

Under § 4 of the 1913 Act every Registered Society shall once in every three years make out and send to the Registrar with the Annual Return for the year, a special return signed by the Auditor or Auditors showing the holding of each person in the Society (whether in shares or loans) at the date to which the said Annual Return is made out, distinguishing such persons by names or by numbers according to the system employed by the Society.

Under § 13 of the Industrial and Provident Societies Act, 1893, the Auditor is empowered to have access to all the books, deeds, documents and accounts of the Society, and shall examine the Balance Sheet showing the receipts and expenditure, funds and effects of the Society and verify the same with the books, deeds, documents, accounts and vouchers relating thereto, and shall either sign the same as found by them to be correct, duly vouched, and in accordance with law or specially report to the Society in what respect they find them incorrect, unvouched, or not in accordance with law.

Under § 14 of the same Act as amended by § 3 of the Industrial and Provident Societies Amendment Act, 1913, every Registered Society must once in every year send to the Registrar an Annual Return of receipts and expenditure, funds and effects of the Society as audited. The form of this Return will be found in the Appendix. A copy of the report of the Auditors, and a copy of each Balance Sheet made during the period must also be sent.

§ 9.—Trustee Savings Banks Acts.

Under § 6 of the Trustee Savings Banks Act, 1863, no savings bank can have the benefit of the Act unless in the Rules and Regulations it expressly provides that a Public Accountant or one or more Auditors be appointed by the Trustees and Managers, but not out of their own body, to examine the books of the Bank and to report in writing to the Board or Committee of Management the result of such Audit not less than once in every half-year; also to examine an extracted list of the depositors' balances made up every year to the 20th day of November, and to certify as to the correct amount of the liabilities and assets of the Bank. The book containing the list of depositors' balances must be certified by the Auditors.

§ 10.—Executors' and Trustees' Accounts.

(a) The Public Trustee Act, 1906.

Under § 13 of the Public Trustee Act, 1906, the condition and Accounts of any Trust shall, on application being made and notice thereof given in the prescribed manner by any Trustee or beneficiary, be investigated and audited by such Solicitor or Public Accountant as may be agreed on by the applicant and the Trustees, or in default of agreement by the Public Trustee or some person appointed by him. The Public Trustee may require the applicant to make a deposit sufficient to cover the costs of the investigation.

The Auditor shall have a right of access to the books, accounts and vouchers of the Trustees and to any securities and documents of title held by them on account of the Trust, and may require from them

such information and explanation as may be necessary for the purpose of his duties, and upon the completion of the investigation and Audit shall forward to the applicant and to every Trustee a copy of the Accounts, together with a Report thereon and a Certificate signed by him to the effect that the Accounts exhibit a true view of the state of the affairs of the Trust, and that he has had the securities of the Trust funds and the investments produced to and verified by him or (as the case may be) that such Accounts are deficient in such respects as may be specified in such Certificate.

If, in the course of the investigation, any person having the custody of any books or documents to which the Auditor has a right of access, fails or refuses to allow him to have access thereto, or in any wise obstructs the investigation or Audit, the Auditor may apply to the Court, and thereupon the Court shall make such order as it thinks just. Any application by the Auditor under this section is made to the Chancery Division by an originating summons, and any order then made will be enforced by a subsequent application for leave to issue a writ of attachment, or for an order of committal for contempt of Court.

The Trustee cannot make terms before producing the necessary books or documents, appeal from the order of the Public Trustee may be made to the Court. (*In re Oddy*, 1911, L J Ch 404)

Unless the Public Trustee otherwise directs, such remuneration and expenses shall be borne by the Estate; but he may order that such expenses shall be borne by the applicant or by the trustees personally, or partly by them and partly by the applicant. But the Public Trustee may in his absolute discretion, upon the application of any Trustee or Beneficiary, direct that

the Investigation and Audit shall extend only to a specified period of time or to a specified part of the Trust property, or shall be otherwise restricted.

The remuneration of the Auditor and the other expenses of the investigation and audit are to be determined by the Public Trustee who may refer the costs of any Solicitor (being part of such expenses) for taxation.

(b) **The Judicial Trustees Act, 1896.**

Under the Judicial Trustees Act, 1896, the Accounts of every Trust of which a Judicial Trustee has been appointed shall be audited once in every year, and a Report thereon made to the Court by the prescribed persons. In all ordinary cases the Accounts are audited by an Officer of the Court, but the Court can refer them to a Professional Accountant for report if it considers the Accounts are likely to involve questions of difficulty.

§ 11.—**Miscellaneous Statutes.**

(a) **The Licensing Act, 1904.**

Under Rule 62 of the Licensing Rules, 1904, the Compensation Authority must appoint a Professional Accountant, approved by the Secretary of State, to be the Auditor of their Accounts.

The Auditor may be appointed for a term not exceeding three years, and his remuneration shall be such as may be fixed by the Compensation Authorities with the consent of the Secretary of State. The Auditor must examine the Annual Financial Statement, with the Accounts and Vouchers and certify the same, making any Report that may be necessary.

(b) Territorial and Reserve Forces Act, 1907.

Under the Regulations made by the Army Council the Accounts of every County Association must be audited by a Professional Auditor, appointed subject to the approval of the Army Council, who must be a member, either of an Institute or Society of Chartered Accountants in the United Kingdom, or of the Incorporated Society of Accountants and Auditors.

(c) The Port of London Act, 1908.

Under § 24 of the Port of London Act, 1908, the Accounts of the Port Authority shall be audited by an Auditor appointed by the Board of Trade, who must report to the Board of Trade if the Port Authority decline or neglect to comply with any of his recommendations or requirements.

SYNOPSIS OF CHAPTER XV.

Special Points in Different Classes of Audits..

- § 1—ASSURANCE COMPANIES
- 2—BANKS
- 3—BRANCH ACCOUNTS
- 4—BREWERIES
- 5—BUILDING SOCIETIES
- 6—CHARITABLE INSTITUTIONS
- 7—CHURCHES
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- 9—COLLIERIES
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- 11—CO-OPERATIVE SOCIETIES
- 12—ELECTRIC LIGHTING COMPANIES
- 13—ESTATE AGENTS, AUCTIONEERS, SURVEYORS, &c.
- 14—EXECUTORS' AND TRUSTEES' ACCOUNTS
- 15—FOREIGN MINES
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- 17—GAS COMPANIES
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- 34—TRUST AND FINANCE COMPANIES.
- 35—TRUSTEE SAVINGS BANKS.
- 36—UNDERWRITERS.
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CHAPTER XV.

SPECIAL POINTS IN DIFFERENT
CLASSES OF AUDITS.

In addition to the general procedure which has been dealt with at length in preceding Chapters, special points arise for consideration in each different class of Audit. It is not possible to deal with every kind of business, and discuss in detail the various special points that have to be considered, owing to the limits of available space. It is proposed to select some of the representative classes of Audits, and indicate the important points that require the Auditor's consideration. Programmes of most of the Audits dealt with in this Chapter will be found in the Authors' *Audit Programmes*.

X

§ 1.— Assurance Companies.

The Assurance Companies Act, 1909, applies to all Assurance Companies carrying on within the United Kingdom the following classes of business:—(a) Life Insurance; (b) Fire Insurance; (c) Accident Insurance; (d) Employers' Liability Insurance; (e) Bond Investment Business; and the Auditor must make himself familiar with the provisions of the Act before commencing the Audit of any Companies of this nature.

In the case of a Life Insurance Company the premium income should be vouched with the Policy Books, Renewals Register, Lapsed Policies, &c., from which it should be possible to verify the premium income in total by taking the gross premium income receivable and deducting premiums on policies matured, surrendered, or lapsed.

The Agents' Commissions should be vouched with the Receipts, Agents' Accounts, &c., and it should be seen that no Commission is paid in respect of business introduced to the Head Office without the intervention of an Agent. The Commission outstanding must be brought into account. Some of the Accounts in the Agents' Ledger should be tested with the returns from the Agents.

- The claims should be tested with cancelled Policies, Papers, Death Certificates, Discharge Notes, &c., and it should be seen that all claims notified but not admitted are provided for.

Surrenders should be tested with endorsed Policies and receipts for cash; payments to annuitants should be tested, and it should be seen that the proportion of annuities accrued to the date of the Balance Sheet is brought into account.

The re-insurances and re-insurance recoveries should be checked, and it should be ascertained that all outstandings on this account are provided for. It should be seen that the premium reserve carried forward is adequate. The verification of the securities, and the income derived therefrom, will follow the usual lines.

- Similar considerations apply to Fire, Accident, and other Insurance Companies. The claims should be tested with the papers relating thereto, and it

should be seen that all claims notified but not admitted are provided for.

The adequacy of the premium reserve carried forward should be fully enquired into, having regard to the nature of the business transacted, and the past experience of the Company.

The Accounts should be drawn up in the form prescribed by the Assurance Companies Act, 1909. The Balance Sheet must state how the values of the Stock Exchange Securities are arrived at, and a certificate must be appended signed by the same persons as signed the Balance Sheet to the effect that in their belief the assets set forth in the Balance Sheet are in the aggregate of the value stated therein less any investment reserve fund taken into account.

Where separate funds are required to be kept the certificate must be appended, signed by the same persons as signed the Balance Sheet, and by the Auditor, to the effect that no part of any such fund has been applied directly or indirectly for any purpose other than the class of business to which it is applicable.

§ 2.—Banks.

In the case of a Bank it is of the utmost importance that a complete system of Internal Check should be in operation, and the Auditor should obtain a written statement thereof.

The following is a summary of the more important points in such a system :—

- (1) The Ledger clerks should be changed about from time to time without previous notice.
- (2) Each clerk should be required to take his annual holiday, and to take it at one time without a break.

- (3) The cashiers should not have access to the Customers' Ledgers.
- (4) The Ledger clerks should have no access to the Cash Book, or the Clearing House Journal.
- (5) The Cash Book should from time to time be compared with the actual records by independent and responsible officials, and subsequently with the Ledgers.
- (6) No Ledger keeper should be a party to testing his own work.
- (7) The periodical balancing of Customers' Accounts with the General Ledger, should be performed by independent officers selected by the Accountant.
- (8) At intervals the testing of the Ledgers should include the "sides" of the accounts in addition to the extended balances, thus affording a comparative check with the Total Summation Book, to which the aggregates of payments and cheques are posted day by day.
- (9) The Branches should be subject to frequent Audits without notice by travelling Auditors or Inspectors.
- (10) An occasional Audit by the Bank's inspector should be in force in respect of the Head Office in the same manner as the Branches.
- (11) Neither Cashiers nor Ledger keeper should participate in the preparation or checking of Bank Pass Books, which should be checked by the Bank's officials independently of the Company's Auditors.

The Auditor should attend at the close of business on the day of the Balance Sheet, and count and weigh the cash in hand. Certificates should be obtained

for the cash at the Bank of England and other Banks. The Cash Articles should be verified ; these are cheques &c., received too late on the last day of the Accounts to be cleared, and can be vouched by seeing that they come through in due course within the next few days.

Money at call and at short notice is usually represented by advances to Bill Brokers on the deposit of Bills from day to day, and to Stockbrokers on the deposit of securities from Account to Account. The Bills should be examined, and the securities lodged by the Stockbrokers checked with the Schedules appended to the Borrowing Notes.

The investments of the Bank must be examined, special precautions being taken to prevent the same securities being produced twice. The Schedule of Investments should show the book value and the market price on the day of the Balance Sheet, and it should be seen that sufficient reserve is made if the total book value is in excess of the market value.

Bills in hand should be examined, and it should be seen that proper provision is made for rebate, representing the proportion of discount not earned at the date of the Balance Sheet.

The securities deposited against loans and overdrafts should be examined, and it should be seen that sufficient margin is provided. The Ledger balances on current, deposit, and loan accounts should be checked, and it should be seen that sufficient reserve has been made for bad debts.

A certain proportion of the Pass-books should be examined by the Auditor with the Ledgers, and he should ascertain that the Pass-books as a whole are examined and initialled each half-year by some responsible Official.

If the Auditor is not instructed to visit the Branches, he should examine the certified Returns, and see that they are properly incorporated in the Head Office books, qualifying his Report to the Shareholders accordingly.

Banks usually possess large Secret Reserves, which should receive the Auditor's attention. This subject has been discussed in Chapter IX., § 12.

§ 3.—Branch Accounts.

In the case of a business possessing Branches the Auditor should ascertain the system upon which the Branch Accounts are recorded, and the manner in which they are incorporated in the Head Office Books. Where he is not instructed to visit the Branches he should examine the returns furnished by the Branches, which should in each case be duly certified by the Branch Manager; and ascertain that they are properly incorporated in the Head Office Books. He cannot in such a case be held responsible for the correctness of the Branch Accounts, and he should limit his responsibility by stating in his Report that he has accepted the certified returns sent from the Branches.

The Auditor should, however, satisfy himself that all questions of principle such as the valuation of stocks, depreciation, reserve for bad debts, &c., have been properly dealt with.

In the case of Retail Branches it is usual to find goods supplied by the Head Office charged out either at cost price, at cost price plus a percentage, or at selling price, stocks in each case being taken on a similar basis, and in the two last cases the Auditor should

see that the values of the stocks have been reduced to cost for Balance Sheet purposes. Schedules of Debtors at the Branch should be submitted duly certified, and the Auditor should ascertain that all liabilities at the Branch not already shown in the Head Office books have been brought into account.

The balances on the Branch Accounts will in such cases usually be represented by Stock on hand, Sundry Debtors, and Cash in hand, and for the purpose of the final Balance Sheet the Branch balances must be divided according to the various classes of assets of which they are composed.

Where a complete set of books is kept at each Branch, and only a Current Account with the Branch kept in the Head Office Books, the Auditor should have produced to him, either the Trial Balance of the Branch or the Branch Profit and Loss Account and Balance Sheet. In such a case the balance of the Branch Current Account in the Head Office Books will represent the capital employed at the Branch, and will be made up of the assets at the Branch less the liabilities. These should be incorporated in the final Balance Sheet under their respective headings. In no case should the balance to the debit of the Branch Account be treated as a Debtor.

All cash remitted from the Branch as shown by the Branch Accounts, should be vouched into the Head Office Books, and similarly all Cash remitted from the Head Office should be vouched into the Branch Accounts. Items of cash or stock in transit should be vouched by ascertaining that they have been received subsequently.

In the case of Foreign Branches the question of exchange will arise in addition to the above-mentioned

points; and the Auditor should check the conversion of the various items into sterling and ascertain that the difference on exchange has been properly dealt with. Where the rate of exchange is sufficiently stable, as in the case of France or the United States, it is usual to convert the accounts on a fixed basis, when the only difference on exchange will arise in connection with remittances, but where the exchange is of a fluctuating character the following rule should be adopted: Fixed Assets should be converted at the original rate at which they were acquired; Floating Assets and Liabilities at the rate on the day of the Balance Sheet; Revenue items at the average rate of the period covered by the Accounts; and Remittances at the actual rate.

• If each item of the Trial Balance is converted at its appropriate rate, the opening balance of the Head Office Current Account being converted at the sterling figure at which it stands in the Head Office books, the difference on the sterling Trial Balance will represent the total difference on exchange. If the difference represents a loss, it should be written off, if a profit it is advisable to carry it forward against subsequent losses arising in a succeeding period.

In all cases where the Auditor accepts certificates of officials or other persons for the verification of assets at Branches, he should mention that he has done so in his Report.

The appointment of local Auditors to audit the Accounts of Branches has been considered in Chapter VI., § 1.

• In the case of a Company carrying on business abroad where the local Accounts are audited by a

local Auditor, the following is a form of Report that may be utilised :—

“In accordance with § 113 of the Companies (Consolidation) Act, 1908, I beg to report to the Shareholders that I have obtained all the information and explanations I have required

I have examined the above Balance Sheet with the books and vouchers in London, and with the returns forwarded from (which have been audited locally), and in my opinion the same is properly drawn up so as to exhibit a true and correct view of the state of the Company's affairs according to the best of my information, and the explanations given to me, and as shown by the books of the Company”

§ 4.—Breweries.

The Auditor should see that there is a proper system for dealing with “Floating Cooperage.” This represents casks out with customers, and it should be seen that the value of these casks is not included in the book debts, but is stated separately.

The Beer Production Account should be examined with the official Excise Book, and it should be seen that the quantities approximately agree subject to wastage.

Where there are managed houses, it should be seen that there is a proper system of check upon the Manager; and that where the stocks of these houses are taken at selling price, a proper adjustment is made back to cost price.

Loans to customers should be checked, and it should be seen that instalments of interest and principal are properly recorded, and that adequate provision is made against loans proving bad. In many cases the Brewery will have guaranteed a loan obtained by the tenant, and it should be seen that the total amount of such contingent liabilities under guarantee is stated in the Balance Sheet.

exchange, instalments on account of the Compensation

Fund should be charged to Revenue, and it should be seen that proper adjustment is made when compensation is received in respect of the cancellation of a License. Where the amount of compensation exceeds the book value of the property, such profit should not go to the credit of Profit and Loss, but should be treated as a Capital profit, against which can be set off corresponding losses. If the amount received is less than the book value, the loss is a Capital loss, but it is advisable that it should be charged against Revenue.

§ 5.—Building Societies.

The numerous frauds that have arisen in connection with the Accounts of Building Societies render it important for the Auditor to take every precaution in the conduct of his Audit, especially as in the case of a large number of the smaller Societies, the system of Book-keeping in use is very inadequate, and the internal check is unsatisfactory. Special attention should be paid to the arrangements with regard to the custody of Mortgage Deeds and other securities.

The Subsidiary and General Cash Books should be checked completely. The rents received from the properties in hand should be vouched, and it should be seen that they bear a reasonable proportion to the values of the properties in the books.

The Pass-books should be examined with the Ledgers, or a proportion of them, care being taken to obtain those called for, and not those offered by the officials.

It should be seen that the amount received on deposit or loan does not exceed two-thirds of the amount secured to the Society by Mortgages on the property of its members.

The Schedules of Properties in Hand should be compared with those of the previous year, and the proceeds of those sold verified ; in a similar manner the Schedules of Advances should be compared, and the receipts of those repaid verified.

The Fire Policy Book should be examined, in order, to ascertain that the Insurance premiums on all the properties mortgaged to the Society are paid up to date.

The securities held for Loans on Mortgage should be examined in the manner indicated in Chapter V., § 5. In the case of large Societies, where the number of deeds is very considerable, and where boxes containing the deeds are kept at the Bank or in the strong room of the Society, and can only be opened by at least two of the Trustees utilising two different keys, it is possible for the following procedure to be adopted :—On the occasion of the first Audit the whole of the securities must be examined. The deeds relating to each security should then be made up into packets, numbered with the number of the security as shown in the Register of Deeds, and sealed by the Auditor with his private seal. On subsequent occasions only new deeds need be examined in detail, the production of the packets with the seals unbroken being sufficient evidence that the securities are intact. Where the packets have been opened for the purpose of reference, the Auditor should re-examine the securities, and re-seal the packets.

It should be remembered that the Auditor has to certify that he has actually inspected the Mortgage deeds and other securities belonging to the Society on the occasion of each Audit, and therefore the adoption of any method such as that indicated above leaves the Auditor open to some risk in the event of fraud being practised, and the Auditor's seal forged and affixed.

to dummy packets. For this reason it may be desirable that the Auditor should open a certain number of the packets at random, to afford some test against this possibility.

The following is the form of Certificate required under § 2 of the Building Societies Act, 1894 :—

“ We, the undersigned, being a person
 who publicly carries on the business of an Accountant at No and
Street
residing at the
 duly appointed Auditors of the above mentioned Society, do hereby attest the foregoing Accounts and Statements and certify that they are correct, duly vouched, and in accordance with law, and we certify that we have and each of us has, at this Audit, actually inspected the Mortgage Deeds and several securities belonging to the Society, in respect of each of the properties in Mortgage to the Society, referred to in the foregoing Accounts and Statements ”

§ 6.—Charitable Institutions.

The income from donations and subscriptions should be checked into the Cash Book from the Counterfoil Receipt Books. The Auditor should see that all spoilt receipts are produced. The receipts should be printed with the name of the Charity, and numbered consecutively.

The receipts from legacies should be vouched with the Legacy Register, correspondence with the Solicitors, &c.

Other income from investments, rents, &c., should be vouched in the manner described in Chapter II., § 4.

As Charitable Institutions are not liable to Income Tax, it should be seen that no tax has been paid, or, where paid by deduction, that it is duly recovered.

The printed list of subscriptions and donations should be checked and agreed with the total shown in the Accounts. It should be seen that all funds left for specific purposes have been applied to those purposes.

In the case of Hospitals, if the Hospital is in receipt of sums from any of the Official Hospital Funds, it should be seen that the Accounts are drawn up in the prescribed form.

§ 7.—Churches.

Owing to the indifferent manner in which Church Accounts are frequently kept, the Audit is sometimes a matter of difficulty.

The Auditor should ascertain that all cash is duly banked, and where balances remain in the hands of Vergers or other officials, these should be counted. The Offertory book should record the receipts from Offertories, and the amount received should be initialled by the Curate-in-charge or the Churchwarden. It should be seen that all Offertories for special purposes are properly dealt with.

Pew rents, if any, should be vouched with the Pew Rent Register, and where the same are divided between the Vicar and the Church, it should be seen that the allocation is properly made.

The Church Title Deeds and Securities representing Endowment Funds (if any), should be examined.

It is customary for the financial year to run from Easter to Easter, in order to prevent two Easters coming into one year's Account.

§ 8.—Clubs.

The Entrance Fees and Annual Subscriptions should be vouched with the counterfoil receipt books, and the total verified with the annual list of members, enquiry being made into those in arrear.

The Steward's receipts should be vouched, and it should be seen that there is an effective system of check as regards the Dining Room, Billiards, Wines, Cigars, &c. Proper Stock Accounts should be kept of Wines, Cigars, &c., and any wines which are not the property of the Club, but of Wine Merchants, should be specially recorded as such.

The question as to the depreciation and renewals of china, glass, linen, plate, &c., is important. Where the original expenditure is capitalised, all renewals should be charged to revenue, but perhaps the best method is to take stock of these items, and revalue them on the occasion of each Balance Sheet. Where heavy expenditure is incurred from time to time in redecoration of the premises, it is advisable that an annual amount should be reserved against each year's accounts, in order that this expenditure may be fairly equalised.

§ 9.—Collieries.

The expenditure on wages is the heaviest item in the Revenue Account of a Colliery, and the Auditor must see that the system of preparing the Wages Sheets and paying wages is a good one, and that all deductions in the shape of cottage rent, &c., are properly dealt with. The Wages Sheets should contain the names of the men employed, the seam in which they are working, the amount of coal got, the rate of pay per ton, the amount due, deductions, and the net amount payable.

The Wages Sheets should be certified, so far as the underground wages are concerned, by the Viewer or Ganger, and as a whole by the Mine Manager.

In order to verify the amount charged in respect of minimum or dead rents, and royalties, the Auditor should inspect the leases, and ascertain the rate of royalty payable, and the provisions in respect of minimum or dead rent, and short workings. Tentail rents are royalties based on tonnage, and in that case the output books should be inspected. Acreage-rents are royalties based on the cubic area of coal worked, and the Auditor should inspect the certificate of the landlord's surveyor. The term short-workings implies the excess of minimum rent payable over the actual royalties on the coal worked, and under many leases it is possible for these to be carried forward, and recouped in subsequent years. Where this is so, the amount can be carried forward in suspense within the period allowed by the lease, which is usually five or seven years, if there are reasonable grounds for expecting the short-workings to be recouped within that time. Where several leases are held, some of which are not worked but have been obtained for the purpose of securing future development, the minimum rent in respect of those leases not worked should be written off, and not carried forward as short-workings.

The Accounts relating to wagons on hire-purchase should be checked, and it should be seen that the proportion of each instalment representing wagon hire is properly ascertained, and charged to Revenue.

The allocation of expenditure as between Capital and Revenue is a matter of great importance. Proper statements should be prepared of the expenditure on wages, stores and materials, charged to Capital, which should be certified by the Engineer or Mine Manager. All the expenditure on the main development of the

Mine can be charged to Capital, but subsidiary development should be written off over the period during which it is expected to prove fruitful, so that by the time the mineral in a particular seam is exhausted, the cost of opening the seam has been written off.

Where depreciation of the Mine property is not provided for, the Auditor should refer to the matter in his Report. Where provision is made, the Auditor should ascertain that it is on a proper basis: in the case of leasehold, according to the term of the lease; and in the case of freehold, in proportion to the output during each period, having regard to the estimated total amount of coal on the property.

§ 10.—Contractors.

Under this heading may be included the accounts of Contracting Companies, Builders, Engineers, Ship Builders, &c., the bulk of whose work is carried out under contract conditions.

The Auditor should examine the system of Cost Accounts in operation, as upon the efficiency of such a system will depend to a large extent the value of the Accounts to the proprietors of the business. It is not within the province of this work to discuss in detail the question of Cost Accounts, for which the reader may be referred to the Authors' work on *Book-keeping and Accounts*; but the Auditor should ascertain the system of dealing with wages and expenditure on stores, materials, &c., also the treatment of indirect expenditure, which is usually termed establishment charges, or "on cost."

The item "Work in Progress" represents the value of uncompleted contracts at the date of the Balance Sheet, and a Schedule showing how the amounts are arrived at should be presented to the Auditor, duly certified. Where proper Cost Accounts have been kept, the Auditor can check the expenditure on each contract with the Cost Accounts relating thereto, otherwise he will be unable to verify the item, and will be obliged to accept it upon the Certificate of the officials concerned.

The question as to whether it is desirable to take profit in respect of uncompleted contracts is important. Where proper Cost Accounts are kept, it is possible to ascertain the profit to date by preparing a Profit and Loss Account in respect of each contract, which will be debited with all expenditure on the contract, in the shape of wages and materials, and credited with the proportion of work certified to date. A valuation must then be made of work done, but not yet certified, stores and materials in hand on the contract, and after allowing for depreciation of plant used on the contract, the balance of the Account, if in credit, should represent estimated profit to date. Another method where contracts are nearly completed is to estimate the cost of completion, and so arrive at the estimated figure of profit to date. Undoubtedly the safest method is not to take any profit until completion; but where this is not adopted, the Auditor should examine the method by which the estimated profit is arrived at, and see that ample margin is allowed for contingencies, at least one-third of the estimated profit being carried forward, regard being also had to the proportion of cash paid on account. In the case of private firms, the matter is one for the decision of the

partners; but in the case of a Limited Company, the Auditor should see that the Accounts clearly indicate the estimated profit that has been taken, and if necessary he should refer to the matter in his Report.

§ 11. —Co-operative Societies.

The Auditor should examine the Regulations of the Society, and ascertain that they are duly carried out.

Shop Sales should be vouched with the Daily Sales Summaries, and the total agreed with the Quarterly Summary of Sales on which dividends are payable.

The Share Ledgers should be examined, and the Capital receipts vouched. Transfers should be tested in respect of dividends not withdrawn, fines, interest, &c. The withdrawals should be vouched, and it should be seen that they are authorized.

The dividend calculations to members and non-members should be checked in total, and tested in detail. The Accounts relating to Clothing Clubs, Penny Banks, Education Fund, Building Department, &c., should be checked, and the Investments and Building Department Mortgages verified.

In addition to the quarterly or periodical Certificate in accordance with the Rules the Auditor must certify the Return sent in annually to the Registrar General of Friendly Societies under § 13 of the Industrial and Provident Societies Act, 1893, as follows:—

"The undersigned having had access to all the books and accounts of the Society, and having examined the foregoing General Statement, and verified the same with the Accounts and Vouchers relating thereto, now sign the same as found to be correct, duly vouched, and in accordance with law."

X § 12.—Electric Lighting Companies.

The Consumer's Ledger, which is usually kept in tabular form, should be tested as far as the debits are concerned with the Meter Books for current consumed, with the Register of Meters for hire of meters, with the Register of Fittings on Hire for the hire or hire-purchase of fittings, and with the Sales Day Books for sale of fittings. The cash received from consumers will be checked from the Cash Book, and after vouching allowances for bad debts, &c., it should be seen that the balances are properly carried forward. Agreements with consumers supplied on special terms, and any Contract with the Local Authority for Public Lighting should be examined.

The allocation of expenditure as between Capital and Revenue is important and it should be seen that a proper system is employed, the allocations being duly certified by responsible Officials.

Repairs and Renewals should be charged to Revenue and it should be seen that adequate depreciation is provided, and that only proper charges are debited to the Depreciation Fund Account. Owing to the heavy wear and tear in respect of Electrical plant and machinery, and the risk of obsolescence, the rate of depreciation provided should be considerably higher than in the case of other plant and machinery. The Accounts must be drawn up in the form prescribed by the Board of Trade, which will be found in the Appendix.

§ 13.—Estate Agents, Auctioneers, Surveyors, &c.

Where considerable sums are received on behalf of clients, whether from Auctions or otherwise, it is

desirable that either a separate Clients' Banking Account should be opened, or that a separate column should be provided in the Cash Book for clients' moneys, in order to avoid any confusion between such moneys and Office moneys. Where such a system is not in force the Auditor should check the credit balances shown in the Clients' Ledger, representing moneys in hand on behalf of clients, and ascertain that there is sufficient cash on the general Banking Account to represent such moneys, drawing special attention to the fact if this is not the case.

Considerable expenditure is frequently incurred on behalf of clients both in respect of advertising and otherwise, and it should be seen that there is a proper system in force for passing the invoices relating thereto and charging the same up to the clients. Similar remarks apply to disbursements incurred through Petty Cash on behalf of clients. Where sums have been received from clients for the purpose of incurring such expenditure at the date of the Balance Sheet and the whole or part thereof remain unexpended, it should be seen that such balances are carried forward as liabilities.

Where outstanding fees and charges, which have not been debited to the clients, are brought into account a schedule should be prepared thereof and signed by the Partners, but care should be taken to see that no items are included that have not been actually earned as the majority of the fees and commissions will only be payable in the event of negotiations for selling or letting the properties concerned being successful.

§ 14.—Executors' and Trustees' Accounts. .

The Auditor should examine the Will and take note of all provisions affecting Accounts, particularly the creation of separate Trust Funds.

In order to ascertain that the whole of the assets left by the Testator have been brought into account the Auditor should examine the Estate Duty Affidavits and Corrective Affidavits, if any.

It should be seen that all apportionments necessary under the Apportionment Act, 1870, or by Case Law, have been duly made and that the same are correct.

The whole of the transactions relating to Capital must be thoroughly vouched, the purchase and sale of investments by examination of the Broker's Bought and Sold notes, receipts from sales of property by Auctioneer's Accounts, &c.

In many cases the Auditor is presented simply with a Cash Account and where this is so it is convenient to prepare a Securities Account in order to ascertain that those securities remaining on hand are all that ought to be accounted for. A good method of doing this is to make a Schedule of the Securities, extending each item at the nominal value thereof on the debit side of the Account, and placing on the credit side against each item the reference to any transactions that have taken place in connection with it, extending the nominal amount thereof. When this has been completed the nominal value of the securities remaining on hand should be represented by the difference between the two sides of the Securities Account.

It should be seen that the investments are duly authorised by the Will or are proper Trustee investments under the Trustees' Act, 1893, or the Colonial

Stock Act, 1900, which will be found printed in the Appendix.

The Auditor should vouch the receipt of the whole of the income in the form of interest, dividends, rents, &c., and ascertain that it has been duly paid to the tenants for life.

Frequently the Auditor is asked to certify Accounts representing the share of a beneficiary on the distribution of an Estate, and before doing so he should ascertain that all payments directed by the Will, such as debts, legacies, duties, &c., have been paid.

The securities should all be produced at the same time and the verification thereof forms a most important part of the Auditor's duty. Where there are two or more Trustees and the securities, or some of them, are registered in the name of one of the Trustees only, the Auditor should report this and suggest that the securities should be in the names of all the Trustees.

The rights and duties of an Auditor of Trust Accounts appointed under § 13 of the Public Trustee Act, 1906, have been referred to in Chapter XIV., § 10, and the following is a form of Certificate which such an Auditor is required to append to the Accounts examined by him subject to any qualification that may be necessary :—

"I certify that the above Accounts exhibit a true view of the state of the affairs of the _____ Trust, and that I have had the Securities and the Trust Fund Investments produced to me, and that I have verified the same"

For the proper conduct of the Audit of Trust Accounts it is necessary to have a considerable knowledge of Trust Law and it is impossible to deal fully with the subject here. The reader may be referred for further information to Ranking, Spicer & Pegler's *Executorship Law and Accounts*.

§ 15.—Foreign Mines.

There are various methods of keeping Foreign Mine Accounts, and in large Mines it is customary for complete Books and Accounts to be kept at the Mine. Local Auditors are frequently employed in such cases, in which event the Company's Auditor will not examine the Mine Accounts in detail, but will confine himself to questions of principle, and to ascertaining that the Mine Accounts are properly incorporated in the Head Office Books.

Where no Local Audit is performed duplicate copies of the Mine Accounts duly certified are usually sent over each month, and in some cases these are written up into Mine Books at the Head Office, which will be examined by the Auditor. In other cases only Cash Accounts are kept at the Mine and certified copies sent over. These Accounts must be vouched by the Auditor in detail, particular attention being given to the payment of wages and to the allocation of expenditure as between Capital and Revenue. The remarks made on this subject in § 9 relating to Collieries apply in a similar manner to other Mines. The allocation should be duly certified by the Mine Manager.

Certified Schedules of the Debtors and Creditors outstanding at the close of the period, Stock of Ore, Stock of Materials on Hand, &c., should be sent over and examined by the Auditor. The proceeds of sale of ore should be vouched by whatever evidence is available, and particular care should be paid to this point where the ore is of a precious nature.

The Mine Manager should make a report with reference to the treatment of the Development Account, and the condition of the plant and machinery at the Mine, and the Auditor should examine this in order to

form some opinion as to the depreciation or other amounts it may be necessary to write off.

The Auditor should check the conversion of the Currency Accounts into Sterling. Where the exchange is constant conversion can be made at a fixed rate, when the only difference that will arise will be in respect of remittances. Where, however, the exchange is of a fluctuating character the fixed assets should be converted at the original rate of exchange, the Floating Assets and Liabilities at the rate on the day of the Balance Sheet, Revenue balances at the average rate for the period, and remittances at the actual rate.

The Title Deeds of the Mine property should be verified, and any items of cash or ore in transit vouched.

§ 16.—Friendly Societies.

The Regulations of the Society should be examined.

The Contributions Cash Book and Sick Payments Register should be checked to the General Cash Book and the latter checked to the Treasurer's Cash Book. The Members Ledger Account should be examined particularly with reference to Entrance Fees and to seeing that new members are properly charged according to age and benefits acquired. A proportion of the Contribution Cards or Pass Books should be examined and tested with the Members Ledger Accounts.

The Management expenses should be vouched and it should be seen that they are properly authorized and that no payments in the nature of Benefits are charged to the Management Fund. Any deficit on this Fund must be made up by levy on the members of the Society.

The various Benefit Fund accounts should be checked and the balances agreed.

All investments should be verified, and these must be either deposited with the Post Office Savings Bank, Trustees Savings Bank, National Debt Commissioners, or made according to the Rules of the Society.

The Accounts must be made up in the form of Return prescribed by the Registrar General of Friendly Societies, which will be found in the Appendix.

The following is the form of the Auditor's Certificate required under § 26 of the Friendly Societies Act, 1896 :--

"We, the undersigned, having had access to all the Books and Accounts of the Society, and having examined the foregoing General Statement and verified the same with the Accounts and Vouchers relating thereto, now sign the same as found to be correct, duly vouched, and in accordance with law"

§ 17.—Gas Companies.

The Auditor should examine the special Act of the Company which will contain particulars relating to the Share and Loan Capital, and state the limitation imposed on dividends. When no rate is prescribed, the limit is 10 % per annum, but if in any year the divisible profits do not amount to the prescribed rate such amount may be taken from Reserve as may be necessary to make up the same. This Reserve is formed under § 31 of the Gas Works Clauses Act, 1847.

The Income of a Gas Company is similar in nature to that of an Electric Lighting Company, and can be vouched by the Auditor in the manner already indicated under § 12. Sales of residuals and fittings should be tested. Where Slot Meters are in use, it should be seen

that a proper system is in force for taking meter readings, independently of the collection of cash.

The Capital receipts should be verified, and in the case of issues subsequent to the original issue, tenders or Auctioneers' Sale Notes should be examined for issues of stock under the Auction Clauses of the Gas Works Clauses Act, 1847.

The allocation of expenditure as between Capital and Revenue is important, and the Auditor should ascertain that the apportionment has been certified by the Company's Engineer. New Works, including additions, should be charged to Capital, but a difficulty frequently arises where new and improved works are put up in place of old works. The method usually adopted is to charge the original cost of the old works, less the value of the old materials, to Revenue, and charge the balance of the expenditure to Capital; but where the cost of construction has increased, this principle has the effect of capitalising a portion of the renewal. Consequently the more prudent method is to estimate the cost of replacing the asset as it stands, and charge such proportion to Revenue, less the value of the old materials, charging the balance to Capital, which will thus fairly represent the present cost of the extension.

Where the works are on Leasehold property, it should be seen that proper depreciation has been provided for, and the investments representing the Depreciation Fund should be examined.

18.—Hotels.

The Auditor should enquire carefully into the system of Accounts utilised, as unless that system is good the opportunities for leakage and manipulation

are considerable. The Visitors' Ledger should be examined, and the daily totals vouched into the Summary, and from the Summary into the Impersonal Ledger and Cash Book. It should be seen that items paid out on account of Visitors are properly charged up to them, and have been duly collected.

Proper Stock Accounts should be kept in connection with Wines, Spirits, Cigars, &c., and the Auditor should test the operation of these Accounts.

The question of the treatment of depreciation of bedding, linen, plate, cutlery, china, &c., is important. It is usual either to revalue these items on the occasion of each Balance Sheet, or to capitalise the original expenditure, and create a Renewals Reserve Account, crediting an ample amount according to previous years' experience, and debiting the actual Renewals, the balance being carried forward.

Proper provision should be made for the depreciation of furniture and premises, and where the furniture is on the hire-purchase system, the Auditor should ascertain that Revenue is duly charged with the interest or hire portion of the instalments paid.

In a large Hotel there will be several Petty Cash Accounts, and the Auditor should arrange for the balances to be verified simultaneously, in order to prevent manipulation.

§ 19.—Insurance Brokers.

The Premium and Claim Journals should be cast, and the totals of the Brokerage and Stamp columns should be checked to the General Ledger. The cross-casts of these Journals should also be checked at the end of each period. In the case of the Premium

Journal, the total debited to clients must equal the total credited to Underwriters and Companies, plus the Brokerage and Stamp totals.

The balances on the Clients' Ledger should be checked, and it should be seen that the Accounts are regularly agreed. Similar remarks apply to the Underwriters' Ledger. Owing to the method of calculating premiums in force at Lloyd's, and to the different Tables adopted, differences are bound to arise which require to be written off, but the Auditor should see that these are not excessive.

§ 20.—Landed Estates.

On the occasion of the first Audit the Counterparts of the Tenants' Leases should be examined, to ascertain the rentals and terms, and these should be checked with the Rent Roll.

The Rent Roll should be compared with the Terrier, which is a survey of the Estate, in order to ascertain that all the properties comprised are entered on the Rent Roll, except those accounted for as unlet or otherwise.

On subsequent occasions only new Leases need be examined.

Rents received should be vouched, and it should be seen that proper authority is forthcoming for deductions or allowances. A Schedule of all properties unlet, or those occupied rent free as part of the emoluments or wages of office, or otherwise, should be prepared and submitted to the Auditor, certified by the Landlord. Arrears should be checked forward from one period to another, and those outstanding any length of time enquired into.

Receipts from sales of produce, stock, timber, game, &c., should be vouched by reference to the counterfoil receipt books.

X § 21. —Motor Omnibus Companies.

The Auditor should ascertain the system in force relating to the collection of receipts. The Traffic Book should be tested with the Conductors' Way Bills; Passenger Receipts with the Traffic Book; Advertisement Receipts with Agents' Returns and Contracts.

Where Motors are purchased on hire-purchase agreements, the contracts should be examined, and it should be seen that the interest or hire portion is duly charged to Revenue.

It should be seen that all maintenance and repairs are charged to Revenue, and where maintenance is carried out by contracts, these should be examined. The question of depreciation is of great importance, particularly having regard to the very heavy wear and tear to which these vehicles are subjected, and to the risk of obsolescence; and it should receive the careful attention of the Auditor.

Similar considerations apply in the case of Motor Cab Companies, although in these cases the receipts are vouched by the Taximeter records.

X § 22. —Newspapers.

The Auditor should vouch the Advertising Day Book with a marked copy of the publication, making enquiry into any dummy advertisements. Amounts received in respect of advertisements not inserted

prior to the date of the Balance Sheet should be carried forward in suspense. Similar remarks apply to the vouching and apportionment of periodical subscriptions.

The question of returns in respect of copies unsold is important, and the Auditor should see that a proper check is in force relating to this item, and that all returns relating to the period covered by the accounts have been credited to the Agents, or reserve made for those estimated to be outstanding.

It should be ascertained that all liabilities in respect of contributions have been included. In some cases, where payments are not regularly made, these may be outstanding a considerable period. The valuation of blocks and electros should be enquired into, as once used these items are worth little, if anything.

The cost of starting a newspaper is very heavy, and involves considerable outlay on preliminary expenses, advertising, special discounts for pushing sales, &c. Such expenditure in excess of the normal may be legally charged to an Establishment Account, and carried forward. Another method sometimes adopted is to charge all expenditure to Profit and Loss, and to transfer the balance of loss in the early years to the Establishment Account: but this principle is somewhat dangerous, as tending to obscure the true result of working, and should certainly be discontinued immediately the paper is fairly established.

If the paper is ultimately successful, and is able to earn an adequate return on the Establishment outlay, the same may be said to represent Goodwill, but it is advisable to write it off out of profits over a period of years.

The Auditor should examine the Establishment

Account, and satisfy himself as to the way in which it has been dealt with.

§ 23.—Publishers.

The Audit of a Publisher's Accounts will vary according to the nature of the transactions. Many Publishers do some, if not the whole, of their own printing, and also carry on a Wholesale or Retail trade in books other than their own, in addition to actually publishing works. They may also be the proprietors of Magazines or Reviews. In each instance the questions arising will be those relative to an ordinary Trading Audit, and need not be referred to here.

Special considerations to which the Auditor should direct his attention are the treatment of the value of copyrights, and the amounts taken credit for in respect of the Production or Prime Cost Account of each Book.

In most cases a separate Production Account is opened for each book, to which is debited the cost of the copyright (if that has been purchased), together with the prime cost of production such as editing, compiling, indexing, setting up type, illustrations, blocks, &c. The cost of printing off, paper, and binding, is debited to revenue, and stock is taken into account on the basis of this cost, which is relatively so small that even if the book is a failure the stock value can as a rule be obtained from a remainder bookseller.

An analysis of all Sales made should be kept in a Stock Ledger, a separate account being opened for each book, and debited with the total number of copies printed, being credited with the number of presentation copies issued and the number of copies sold, the balance representing the number of copies in stock.

From an examination of this book it will be possible to ascertain at a glance the way in which the sales of each book are progressing, and valuable information will be thereby afforded as to the manner in which the Production Account should be dealt with. Where a second edition is not contemplated this Account should be written down in the proportion that the actual sales bear to the estimated sales, or the whole edition, where it is expected this will be disposed of. Where a second edition is contemplated casts of the type are usually taken and stereos prepared therefrom, the cost of these items being debited to the Production Account, which will not then be written down so rapidly.

Where such a system as that above described is not in force but the whole cost of production and printing is charged to revenue, Stock and Copyrights being valued accordingly, these should not be valued above cost, and the Auditor should see that where the whole edition is not likely to be sold, the value is reduced accordingly.

Where the Publisher does not care to incur the risk involved in publishing a book, it is a common practice for him to accept it at the Author's risk, receiving for his services an agreed commission on the sales. In such a case an Account will be opened for the book and debited with the total cost by way of production or otherwise. The sales of the book will be analysed from the Sales Day Book, or kept in a separate Day Book, and credited to this Account. The Commission on Sales will be debited, and the balance will then represent the sum due to or by the Author, any sums received from the Author to cover cost of production, having been credited in the first instance. In

these cases the question of copyright and stock values does not arise, and care should be taken to see that no stocks of this nature are included in the general stock.

Where books are sent to Booksellers on the Sale or Return principle, it should be seen that the transactions are properly dealt with in accordance with the principles laid down in Chapter III., § 3.

The Auditor should ascertain that all Royalties to Authors outstanding have been provided for. Where advances have been made on account of Royalties, and it is found that the sales are not likely to prove sufficient to provide the necessary sum, the balance, by custom of trade, is not repayable by the Author, and should be written off or reserved for.

§ 24.—Railway Companies.

Most Railway Companies have an elaborate system of internal Audit, which is carried out by the Audit staff, and the Auditor should ascertain the principles upon which this check is conducted. The Coaching, Goods, Minerals, and Special Receipts Ledger Accounts should be checked with the Monthly Summaries, and the Monthly Summaries with the Station and Depot Balance Sheets, which should be properly certified by Station Masters, Companies Agents, Mineral Agents, and by the Audit Department.

The Cash Summaries should be checked to the General Ledger Accounts, and the Summaries tested with the Cash Books.

Receipts from Season Tickets should be vouched. The deposits, and the unexpired balance of the tickets should be carried forward as liabilities.

It is impossible for the Auditor to vouch the whole of the payments, but he should test a certain proportion. The outstanding debtors should be vouched with the Coaching, Goods, and Minerals Balance Sheets, and the Departmental Certificates; and the outstanding liabilities with the Certified Returns. The Clearing House Journal should be vouched with the Railway Clearing House Statements. Rents receivable should be verified in the usual manner. Capital issues and redemptions should be vouched.

The allocation of expenditure between Capital and Revenue is of the utmost importance. Under the Regulation of Railways Act, 1868, a Certificate must be given by the Engineer, relating to the maintenance of the permanent way, &c., and by the Chief Engineer or Locomotive Superintendent respecting the rolling stock. The cost of maintenance must be charged against Revenue; and the Auditors are required to certify that in their opinion the dividends proposed to be declared are *bonâ fide* due after charging the Revenue of the year with all expenses which in their judgment ought to be paid thereout.

All original expenditure on the permanent way, rolling stock, &c., is properly chargeable to Capital, and can remain to the debit of that Account, except that where Capital assets, such as lands, &c., are sold, the Auditor should see that the amount received goes to reduce the Capital expenditure. Difficulty arises in the treatment of renewals and replacements that are improvements on the original asset, as, for instance, the expenditure involved in pulling down and re-

building a Station on a larger plan, in order to cope with increased traffic, and to meet the demands of the public. Similarly, additional expenditure is continually being incurred, in improving rolling stock and in other ways, which is forced upon the Railway by public demands, but which does not necessarily of itself earn additional revenue.

Theoretically, the cost of all such additions can be charged to Capital, and in many cases this has been done, but the ultimate effect of such a policy is to burden the Capital Account with a great deal of dead expenditure, which is bound in the end to reduce the average dividends earned on the Capital employed. On the other hand, some of our best managed Railways charge a large proportion of the cost of these betterments to Revenue.

The question of the rise in the cost of construction has been referred to in connection with Gas Companies' Accounts, and the principle indicated there applies also in the case of Railways, namely, that the present cost of replacing the old asset should be charged against Revenue, rather than the original cost, in cases where the former has increased.

The form of Accounts prescribed by the Railway Companies (Accounts and Returns) Act, 1911, will be found in the Appendix, and the following is the form of the Auditor's Certificate required by § 30 of the Railway Companies Act, 1867, as amended by § 4 of the first-mentioned Act :—

"We hereby certify that the foregoing accounts contain a full and true statement of the financial condition of the Company, and that the dividends proposed to be declared on the stocks and shares of the Company are *bond fide* due thereon after charging the revenue of the year with all expenses which, in our judgment, ought to be paid thereout."

§ 25.—Retail and Co-operative Stores.

The duplicates of bills handed to customers should be tested with the Abstracts prepared by each salesman, and the Abstracts checked into the Departmental Cash Received books, the daily totals of these books being checked into the General Cash Book. Some of the duplicates for Credit sales should be checked with the Sales Journal. Invoices for purchases should be tested, and it should be seen that they are properly allocated to the various departments. The allocation of Departmental charges should be checked.

Where the Departments are charged with goods at selling price, or at a percentage above cost, as frequently happens where there are Branches, the Auditor should ascertain that the Stocks of such Departments are reduced back to cost before being incorporated in the final Accounts.

§ 26.—Rubber Companies.

The Auditor should examine the certified monthly returns sent over from the plantation, and ascertain that the expenditure has been properly apportioned as between Capital and Revenue. In addition to the purchase price of the property the Capital expenditure will take the form of payments in respect of Buildings, Plant and Machinery, New Clearings, and Rubber not in bearing. The general charges at the plantation are usually apportioned between Capital and Revenue in the ratio that the area producing bears to the area cultivated. The report

of the Visiting Agent, if any, on the apportionment of this expenditure should be examined.

The Revenue expenditure will take the form of general charges, upkeep and repairs, cultivation of rubber in bearing, and rubber manufacture.

In most cases the rubber produced is sold on the London Market, and the Manager's Return of Shipments should be agreed with the Brokers' Sale Notes, subject to shrinkage in weight. The stock of rubber on hand at the date of the Balance Sheet is usually brought into account at sale price, as it will generally have been sold before the accounts are prepared.

Advances to Coolies to be recouped out of their wages during their term of service should be revalued on the occasion of each Balance Sheet, and certified to by the Manager, as owing to death and other causes the whole of these advances may not be recovered.

Other produce may be cultivated such as rice, sago, coffee, &c., separate accounts being kept in respect of the expenditure on such class of produce, so that the profit thereon can be ascertained. All expenditure on new crops can be carried forward.

In the event of the Title Deeds being retained locally, the Auditor should obtain a certificate from the Company's Bankers, or some responsible person, stating that the Title Deeds are held free from charge.

The Auditor should ascertain that the returns are properly incorporated in the Head Office books, and that the difference on Exchange has been correctly adjusted in accordance with the principles laid down in § 3 of this chapter. Items of Stock, or Cash in transit should be vouched.

Similar considerations apply to the Audit of other classes of Plantation Companies.

§ 27.—Schools, Colleges, and Universities.

The Auditor should vouch the fees received with the Register of Pupils, and ascertain that those outstanding will be duly received, and that all extras have been properly charged up. Any fees paid in advance in respect of a period subsequent to the date of the Balance Sheet should be carried forward.

The Capitation Fees, paid by House Masters for the pupils in their Boarding Houses, should be vouched.

The Charter and Regulations (if any) should be examined, and, where Endowments exist, the income arising thereunder must be vouched, and the securities verified. Government Grants, if any, should be verified.

In the case of Universities where the Universities and Colleges Estates Acts, 1858 to 1898, or the Universities of Oxford and Cambridge Act, 1877, apply, the Auditor should see that the provisions thereof are duly complied with.

§ 28.—Shipping Companies.

The Auditor should examine the Articles of Association, Agreements with Managing Owners, Captains, &c.

The original cost of the Ships should be vouched, and, in the case of a Single Ship Company, it should be seen that no addition has been made thereto, after the total first cost has been divided into 64 shares. In the case of a Shipping Company owning a fleet of vessels, only such additions should be made to the Cost Account as represent proper Capital Expenditure.

The Auditor should examine the Bill of Sale for

each Ship, or part of Ship, owned, and note that a copy of the entry in the Register kept at the Port of Registry is endorsed thereon, or obtain Certificate of Registry as to ownership, and Mortgages outstanding. A Mortgage on a Ship is effected by means of a Bond, which must be obtained from the Custom House in the prescribed form, for the consent of the Board of Trade, and returned to the Customs at the Port of Registry, where particulars of the Bond will be entered against the Vessel in the Register of Shipping. The Mortgage will be retained by the Mortgagee, but its priority dates from the date of production for registry, and not from the date of the instrument.

Voyage Accounts are kept in respect of each voyage, and should be vouched by the Auditor. It should be seen that each voyage is properly charged with the expenditure on Stores. The Freight Accounts should be vouched with Manifests from Agents, and Advices from Receiving Offices, and it should be seen that proper reserve is made for outstanding rebates. Passengers' fares, if any, should be vouched, and it should be seen that proper reserve is made for return fares outstanding. All outstanding expenses on each Voyage Account should be provided for before closing the Account. The Accounts of the Home Agents and Foreign Agents should be examined with the vouchers, and it should be seen that foreign exchange is correctly adjusted. The Captain's Accounts should be examined and vouched in detail, and it should be seen that his remuneration is in accordance with his agreement.

The Insurance Policies should be examined, and it should be seen that the premiums are properly apportioned over each voyage, and that returns are

claimed from the Underwriters where ships have been laid up, or for other reasons. Where the Policy is a Time Policy, the proportion unexpired should be carried forward. It should be seen that the amounts received in respect of claims are properly dealt with.

- Payments to or by Protecting Clubs for insurance of extraordinary risks should be vouched in a similar manner.

Charter Parties should be examined as to Brokerage, Commissions, and Rates of Freight, and it should be seen that agreed returns have been credited to each Voyage Account.

Where a number of ships are owned by the Company, the Auditor should ascertain that proper depreciation is provided.

- In the case of Single Ship Companies, it is not usual to provide any depreciation, but the Auditor should refer to this matter in his Report to the Shareholders so that they may be aware of the position.

In the case of Shipping Companies owning a fleet of vessels, it is common to find an Insurance Fund in operation, under which the Company undertakes the whole or part of the insurance of its vessels. This is effected by debiting to the respective Voyage Accounts, and crediting to an Insurance Fund Account, premiums at the same rate as would be payable to Underwriters, or sometimes at a slightly higher rate, a corresponding amount being invested in outside securities, in order that when claims arise moneys will be forthcoming for the repair or purchase of ships. Any losses will be debited to the Fund Account, and re-insurances where these have been effected, also the cost of administering the Fund; the Fund Account, on the

other hand, will be credited with interest on investments representing the Fund, re-insurance re-funds, &c.

No profit should be taken in respect of the operation of such an Insurance Fund until it has reached an amount in excess of a reasonable valuation of the risks borne by the Company. This valuation should be made under expert advice, and will take into account the number and age of the vessels, the class of trade carried on, and the nature of the voyages. Assuming a profit to have been made, it should not be taken to the credit of Profit and Loss Account; but if it is desired to distribute it to the Shareholders, this should be done by means of a bonus. Some Companies, in place of distributing underwriting profits, utilise them for the purpose of acquiring additional ships, and make a corresponding transfer from the Insurance Fund Account to General Reserve.

§ 29. -Solicitors.

The Auditor should ascertain the system upon which 'Clients' and Office moneys are dealt with, as this is a matter of the greatest importance. The Law Society recommend that a Solicitor should utilise two Banking Accounts: one for 'Clients' moneys and one for Office moneys. Where, however, only one Banking Account is adopted, two columns should be provided in the Cash Book, for 'Clients' and Office moneys respectively, as in this way the Solicitor can ascertain from day to day what balance he has in hand on each Account. Separate Banking Accounts should be opened in the case of all large matters.

Whichever system is in vogue, cheques should only be drawn out of Clients' moneys where there are moneys in hand, on account of the particular Client concerned,

against which the same can be set off. Any cheques drawn on account of Clients who have no amounts standing to their credit must be treated as Office payments. When costs are deducted by the Solicitor from Clients' moneys on final settlement, an adjustment in respect of such costs should be made between the Clients' and Office cash. This is sometimes done in respect of each transaction, but in other cases it is done at intervals, say once a month, and an analysis of the balance on Clients' account inserted, showing how it is made up.

The Auditor, in checking the balances on the Clients' Ledgers, should ascertain that all credit balances which ought to be represented by moneys in hand are covered by the balance on the Clients' account according to the Cash Book ; or where no system such as that above indicated is adopted, but merely one General Banking Account kept, that the balance on that Account is sufficient to cover liabilities to Clients. Where this is not the case the matter should be reported.

The system of dealing with Petty Cash disbursements should be examined, and it should be ascertained that all disbursements made on account of Clients are duly charged up to their Accounts. In the case of a large Office there may be several Petty Cash Accounts, the balances of which should be counted simultaneously.

In checking the Clients' Ledger, allowances to Clients should be vouched, and it should be seen that amounts disallowed on taxation are properly adjusted. Where disbursements, such as Counsel's fees, have been charged to Clients, but have not been paid by the Solicitor at the date of the Balance Sheet, it should be seen that the same are brought in as liabilities.

Credit balances may be found representing moneys paid by Clients on account of costs and disbursements which have not yet been debited. If such a payment is wholly on account of disbursements which have not yet been made, the item will in effect be a liability; but where the whole, or a portion, is in respect of costs which have been earned, but which have not yet been debited to the Client, owing to the fact that no bill has been rendered, the Ledger Account should be adjusted by passing an entry through the Bills Delivered Book for the amount received on account of costs, debiting the Client's Account therewith.

In order to ascertain the profit correctly, it is necessary that the undelivered costs should be valued, and a Schedule should be prepared from the draft Bills of Costs. The valuation should be made on a conservative basis, provision being made for allowances, whether voluntary or by taxation. All items which are in any way doubtful should be omitted. This Schedule should be signed by the Partners.

Many Solicitors, however, prefer to leave out of account undelivered costs, not debited to Clients. In such cases, it is advisable that a note should appear on the Balance Sheet, stating that these items are not brought into account.

In the absence of agreement to the contrary, Articled Clerks' premiums should be apportioned over the term of the Articles.

§ 30.—Stockbrokers.

The books of a Stockbroker are usually balanced each Account, or at least once a month. Where a full Audit is carried out, the whole of the postings will

be checked, the books cast, and the balances checked on the occasion of each Account. Owing, however, to the great amount of detail involved, this course is not always adopted, and a partial Audit may be carried out, the object of which is to test exhaustively the detail work, and to verify the securities.

In checking the balances on the Clients' Ledgers, it should be seen that sufficient cover is held for all debit personal balances of importance, as referred to below, and the manner in which the various balances are made up should be ascertained. Similar remarks apply to the balances on the Partners' Accounts, representing their private speculative dealings. In checking the balances on the Jobbers' Ledgers, it should be ascertained that they have been properly agreed with the Jobbers on the occasion of each account, when it is usual to settle for the balance so agreed. Any balances carried forward for a considerable time, without subsequent dealings, should be enquired into, as they may represent items in dispute. In this connection the Splits Account should be examined. This Account is utilised to adjust small differences, and any items of consequence passed through it should be investigated, as it has frequently been utilised to cover petty frauds.

The Contango Books, or Bought and Sold Continuation Books, should be examined, as these record the treatment of Stocks carried over. Where a Client has bought Stock but does not wish to pay for it, he must arrange with his Broker for it to be carried over, and this will be done either by the Broker himself, or by the Jobber through whom the Stock was bought. If carried over by the Jobber, the Client's Account will be credited, and the Jobber's Account debited; if by

the Broker, the Client's Account will be credited, and the Loan Account or Loan Ledger debited. Similar entries, but on the reverse principle, will be made when Stocks are sold for Clients, but not delivered by them, the Client's Account being debited, and the Jobber's, or the Broker's Loan Account, being credited. These entries are put through on Contango day, and are reversed at the commencement of the next Account, Stock bought but not taken up by the Client being re-debited to him, plus the cost of Contango, which represents the charge for the accommodation and takes the form of interest on the value of the Stock carried over, or a fixed rate per share.

The Loan Ledger referred to above will thus contain particulars of Stocks taken in by the Broker on behalf of Clients, and will usually be found to be divided between Registered Stocks, Bearer Stocks, and Consols, or in other ways according to the nature of the business carried on. The balance on each section should be represented by securities as mentioned below.

When Registered Stock is sold by a Broker on behalf of his Client, the ultimate purchaser will not be known until the close of the account. Accordingly on Ticket Day, a ticket is issued by the purchaser, whether Broker or Jobber, and handed to the Jobber from whom the stock was bought, who endorses it with the name of the party from whom he purchased the stock, and delivers the ticket so endorsed to him, this operation being repeated until the ticket reaches the selling Broker, differences as between one transaction and another being adjusted between the various parties.

The selling Broker will then fill up the Transfer Deed incorporating the particulars shown on the

ticket, and, after having obtained the signature of the seller, will deliver the transfer Deed, with the Stock Certificate and the ticket, to the buying Broker, receiving payment in exchange.

When received by the selling Broker this ticket is termed a "Ticket Receivable." The Ticket Receivable Book should be exhaustively tested by the Auditor, who should ascertain that the amount outstanding at the close of each account is subsequently cleared off.

When Registered Stock is purchased by a Broker on behalf of his client, he himself issues a Ticket which is termed "Ticket Payable." The Auditor should test the Tickets Payable Book, and ascertain that the balances outstanding are subsequently cleared off.

The General Ledger should be checked entirely, and will contain accounts for Commission, Interest, and Expenses. The Commission should be checked from the Commission columns of the Purchases, Sales, and Special Settlement Books, and it should be seen that all half commissions payable have been duly provided for. The Expense Accounts should be vouched, and it should be seen that all outstanding liabilities are brought into account.

The Firm's Investment Ledger, representing Investments held by the Firm, should be checked in detail.

The verification of the securities is the most important and difficult part of the Audit. It is sometimes arranged for this to take place several times during the year, without notice being given to the Staff of the Office. In this way a considerable moral check is exercised. In any event the verification must be

performed for the purposes of the annual Balance Sheet. The securities will be of five classes :—

- (1) Securities taken in on Loan Account, as above mentioned.
- (2) Securities held by the Firm as Investments, according to the balances in the Investment Ledger.
- (3) Securities held as cover against loans made by the Broker, or balances due from Clients.
- (4) Securities awaiting delivery against Tickets Receivable.
- (5) Securities held for safe custody on behalf of Clients.

The Auditor should attend as soon after the close of the Account as possible, in order to avoid the numerous adjustments that become necessary if the examination of the securities is delayed, and dealings take place. The securities should all be produced at the same time, and should be checked off by the Auditor with the Security Book or Schedules. The Security Book is a Memoranda Book, which is made up for each Account, showing the total amount and value of securities held, the parties on whose account they are held, and to whom they have been pawned, if at all. If not pawned, they will be in what is called the "Box," i.e. either in the strong room of the Firm, or in a box deposited with their Bankers. This book will not contain particulars of the securities held for safe custody on behalf of Clients, which should be recorded in a separate book. Columns should be provided for the name of the Client, the name of the Stock, the making-up price, the value, the amount of the Client's balance against which the Stock is held, and note should be made whether the Stock

is in the box, or has been pawned. It must be seen that there is sufficient margin where Stock is held as security, the making-up prices and calculations being checked for this purpose, and the Clients' balances being compared with the Ledger Accounts. Care must be taken to see that all securities held according to the books are contained in these Schedules, and Certificates must be obtained from all Banks and other parties, to whom Stocks have been pawned as cover for loans, stating the amount of the loan and the various Stocks held. These Certificates will be checked off, and will serve to verify the existence of the Stocks mentioned in them. All remaining Stocks should be in hand, and be examined by the Auditor, the usual precautions being taken to prevent Stocks being produced twice over.

In addition to the securities being checked in the manner above described, they should also be checked off with the Memoranda books, usually termed "Number" Books, or "Bearer" Book and "Registered" Book respectively, and the Auditor should see that he has obtained evidence in respect of all Stocks open on these books.

Securities held for safe custody on behalf of Clients will not appear in the books from the point of view of Double Entry. A special Memorandum Book should be kept to record these securities, but in many cases it is found very difficult to do this, and they are included in the General Memoranda Books referred to above. In any case, it is impossible for the Auditor to prove that all securities held for safe custody are produced to him, and he should be careful to refer to this point in his Certificate or Report.

§ 31.—Stockjobbers.

The Accounts of a Stockjobber or Dealer, although in many respects similar to those of a Broker, differ in some important essentials. The business of a Jobber or Dealer is to buy and sell as principal, whereas a Broker merely buys and sells, as Agent for his Client, from or to the Dealer. Consequently the profit of a Broker is obtained from the commission charged by him for his services, whereas the profit of a Dealer is derived from selling Stock at a higher price than he gave for it, or buying Stock at a lower price than that for which he has previously sold it.

The Stock Journals or Ledgers record the dealings in each particular Stock for each Account, and columns are provided for the quantities of Stock dealt in as well as the money values. If the opening balance is a debit, it represents Stock in the Box at the commencement of the Account; if a credit, it is termed "Name-over," and represents Stock which has been sold but not delivered. Where the Jobber has purchased more Stock than he has sold he is a "Bull" for the balance he holds; where he has sold more Stock than he has purchased he is a "Bear" for the balance. At the close of each Account the balance of the quantity columns, whether Box or Name-over, is inserted at the making-up price, or otherwise as the case may be, and this should agree the Stock quantity columns. The Money columns, however, will not usually agree, and the difference will represent profit or loss on the dealings during the Account, which should be transferred to a Profit and Loss Book.

The Auditor should check the opening and closings, both quantity and value. Postings from the Cash Book for application and allotment money.

on Stocks applied for, Underwriting Commission, &c., should be checked to the various Accounts; the postings from the Jobbers' or Brokers' Ledgers should be tested; the Stock columns cast and agreed, and the profits and losses checked to the Profit and Loss Book. Joint Books are frequently kept with other Jobbers, the profits or losses being divided by mutual agreement, and the Auditor should see that the necessary transfers have been made.

For the purposes of the Balance Sheet the balances in the Stock Ledgers should be agreed with the "Bull and Bear" books kept by the Partners or their authorized Clerks, which are Memoranda Books recording the dealings from day to day of each Stock in quantities only. The Auditor should examine these books and ascertain that the Bull or Bear agrees with the Stock Ledgers both as to quantity and price, the price being usually marked by the Partners for Balance Sheet purposes in the Bull and Bear Books. The Auditor should also check the calculations of the values of the Stocks, as any error in extending the values affects directly the profit or loss.

The Dividend Journal records the dividends receivable or payable. The Auditor should ascertain when the various Stocks become quoted ex div. If the Jobber is Bull of the Stock, the dividend thereon should be ultimately received and taken to the credit of the Dividend Account; if he is Bear of the Stock the dividend in respect thereof will be payable by him. If the Stock is "even," any dividends received will be payable to other persons, and should be treated as a liability, if not paid over at the date of the Balance Sheet.

The verification of the securities should be carried

out in a similar manner to that described in the case of Stockbrokers, but the securities to be examined will be all of one nature, namely, those recorded as Box balances in the Stock Journals or Ledgers. The Schedule of these should, therefore, be checked with the Ledgers as to quantities and verified in the usual manner, Certificates being obtained from Bankers and others where securities have been pawned for advances. In the case of Registered securities, the evidence will take the form of Certificates, Balance Certificates, Transfers, Transfer Receipts, &c., and great care must be exercised by the Auditor to ascertain that the total balance of each Stock held is duly vouched in one form or another in accordance with the principles set out in Chapter V., § 3.

§ 32.- Theatres.

The receipts of a Theatre or Music Hall to a large extent take the form of coin, and the Auditor should ascertain that the system of recording the receipts is satisfactory, and that the same are paid into the Bank at least once every day.

The daily returns from each Box Office should be signed by the Box Office official concerned, and entered daily on a final return which should be certified by the Treasurer. The final returns should be vouched on to the weekly summaries of income and expenditure, which are usually termed Balance Sheets.

The Libraries and agents usually settle for seats weekly, and these receipts should be vouched with their returns which will also disclose any amounts outstanding at the date of the Balance Sheet.

Receipts from the sale of programmes should be vouched to the weekly Balance Sheets from the Programme Book, the amounts being entered after deducting the commission payable to the sellers. Similar remarks apply to vouching receipts from the sale of sweets, with the Sweets or Chocolate Book. Receipts from the hire of Opera Glasses should be vouched with the Opera Glass Book, except in cases where the glasses do not belong to the Theatre, but are furnished by contract, when the contract will be examined.

Receipts from advertising on programmes or on the curtain will be vouched with the Advertisement Book and contracts. It should be seen that a proper check is in force relating to the Bar receipts. It is usual to charge each bar with supplies at selling price to enable the stock to be checked. The daily summary of takings in each bar should be vouched on to the final daily return, which will be vouched to the weekly Balance Sheet.

A daily summary of the various final returns should be made, representing the amount paid into the Bank, and the Auditor should examine these with the Pass Book, care being taken to see that the dates correspond. Cases have been known where the takings have been regularly manipulated, so as to permit of one or two days' takings being nominally in 'hand,' whereas actually they have been misappropriated.

It should be seen that the amounts charged in respect of Cost of Production, or Mounting Account, only represent the actual expenditure on the scenery and dresses, though no objection can be taken to the allocation to this Account of salaries, lighting, and other expenses incident to rehearsals. The Auditor

should ascertain that the amount taken credit for in the Balance Sheet in respect of this account is not excessive, having regard to the life of the play concerned, and its prospective earning power.

The system adopted for preparing and paying wages should be examined. The wages are usually divided between "front" and "back," the former relating to persons employed in the front of the house, such as Box Office officials, programme sellers, attendants, &c., while the latter relates to persons employed behind the stage, such as carpenters, scene shifters, mechanics, &c. The Artists' salary list should be vouched with the contracts with each individual artist.

The expenditure on advertising is a heavy item, and should be vouched with the contracts.

Receipts in respect of Touring Companies should be vouched with the certified returns, submitted by the Manager of the Theatre visited, the percentage of the receipts payable to the Touring Company being vouched with the contract. Travelling expenses should be vouched with the Touring Manager's certified Schedule, and Cartage on Scenery with the vouchers.

X § 33.—Tramways.

The Auditor should vouch the Traffic Receipts by testing the Traffic Sheets with the Conductors' Way Bills, Tickets &c., and vouching the Sheets into the Traffic Books seeing that all receipts are ultimately paid into the Bank. The advertising is usually let out by contract, and the receipts can be vouched by reference to the Contracts.

Tramway Companies usually prepare their Accounts on the Double Account system, but, unless they come under the heading of Railways, no specific form of Accounts is required. In the case of Electric Tramways, owing to the rapid depreciation that takes place, and to the comparatively short mileage of most Undertakings, the Double Account system cannot be regarded as satisfactory, unless ample reserves are made for future renewals and depreciation, in addition to charging the current cost of maintenance to Revenue.

The allocation of expenditure as between Capital and Revenue must be examined by the Auditor, and he should see that it has been duly certified by responsible Officials.

§ 34.—Trust and Finance Companies.

The purchase and sale of investments should be vouched by inspection of Brokers' Contract notes, and where transactions are carried through cum or ex dividend, it should be seen that apportionments are duly made. It should be ascertained that all dividends and interest that ought to have been received have been received. Securities should be verified in the usual manner, and the book value should be compared with the market value at the date of the Balance Sheet. It is not usual to adjust the value of each investment to market price, but to reserve on the difference between the total book value and the market value, if necessary.

Losses on sale of investments should be charged either to Revenue or to any Investment Reserve Account the Company may possess. Profit on the sale of investments can be taken to the credit of the

Profit and Loss Account, if the Articles do not prohibit this course, though it is not usual to do this, but to carry such profits to an Investment Reserve Account, or to General Reserve. Investments should not be written up but on a re-valuation the increase in value of some can be set against the decrease in value of others.

Where shares are not fully paid the contingent liability in respect of calls not yet made should be stated on the Balance Sheet; but where calls have actually been made, which have not been paid by the Company, the amount should be treated as a liability.

In the case of a Trust Company proper, it has been held that the investments are fixed assets, and that, subject to the Articles, the excess of current income over current expenditure can be divided without making good depreciation on the investments (*Verner v. General and Commercial Investment Trust, Ltd.*, 1894, 2 Ch. 266). This decision has been discussed at length in Chapter X., § 1. Where depreciation has not been provided for, the Auditor should see that a note is made on the Balance Sheet of the present market value of the investments, and where necessary he should refer to the matter in his Report to the Shareholders.

In the case of a Finance Company, whose primary object is not to hold investments for the purpose of earning income, but to buy and sell shares at a profit, the investments so held cannot properly be regarded as fixed assets, but should be treated as floating assets, and brought into account at their value as at the date of the Balance Sheet. It is frequently a matter of great difficulty to arrive at a proper value to be placed on speculative shares, particularly where they

are held in Companies which have been promoted by the Finance Company. The only sound system to adopt is to treat these shares on a cost basis, making the necessary reserves, if they have depreciated below cost. It is not always possible to rely on market quotations in the case of newly-promoted Companies, since such quotations are frequently merely nominal, and do not represent actual value.

Where promotion profits have been received in fully-paid shares, the same should not be brought into account at their nominal value. If there is a cash profit on the promotion, apart from the shares, the latter should remain unvalued until realised, when the amount so realised can then be treated as profit. If, on the other hand, there is a cash loss on the Promotion Account, the same can be regarded as the cost of the shares acquired, which can be brought into account at this figure, subject to depreciation.

Where underwriting transactions have been entered into, and the Finance Company have been obliged to take up shares, the underwriting commission received should be set against the cost of the shares so taken up, and not treated as profit.

Generally speaking, it may be said that the safest method is that the Profit and Loss Account should only be credited with actually realised profits. Where the Accounts are not prepared in this manner, but credit is taken for profit represented by shares unsold, the Auditor should deal fully with the matter in his Report to the Shareholders. In some cases a separate Profit and Loss Account is compiled, showing the share profits, and this method is convenient where scrip dividends are declared payable in the shares of other Companies.

The Auditor should ascertain what, if any, transactions are open on the Stock Exchange at the date of the Balance Sheet, since shares may have been purchased but not taken up, or sold but not delivered. In either event the contingent liability might be considerable. Where the transactions have been closed subsequent to the Balance Sheet, and the result is ascertained, the same, if a loss, should be provided for; but a profit should not be taken credit for. Where, however, the transactions remain open at the date of the Audit, a note should appear upon the face of the Balance Sheet, stating that there are contingent liabilities in respect of transactions open on the Stock Exchange; and if the Auditor considers the matter important, he should deal with it in his Report to the Shareholders.

All transactions with allied Companies should be carefully examined, and it should be seen that no manipulations are effected for the purpose of "Window-dressing" the respective Balance Sheets.

§ 35. -Trustee Savings Banks.

The Auditor should ascertain that the totals of the subsidiary Cash Books are correctly entered into the General Cash Book. The Bank Balance should be verified, and the Cash in hand counted.

The postings from the Cash Book to the Depositors' Ledgers should be tested, and also the calculations of interest credited to Depositors. It should be seen that the Statutory limits of yearly and total deposits, namely, £50 and £200 respectively, are not exceeded. The Auditor should examine some of the Depositors' Pass-books with the Depositors' Ledgers, not accepting

those offered by the Officials. This examination should be more or less continuous throughout the year, so that not less than 10 per cent. of the Pass-books are examined in the course of the year. The Balance Book should be checked with the Depositors' Ledgers, and it should be seen that the total thereof agrees with the balance of the Depositors' Account in the General Ledger. This Balance Book is open for the inspection of all Depositors, and contains no names, but each Depositor has a number attributed to him. The Auditor is required to certify that he has examined this list.

The National Debt Commissioners' Account should be examined for the purchases and sales of Stocks, transfers, interests, &c.

§ 36. - Underwriters.

Before commencing the Audit of the Accounts of an Underwriter at Lloyd's, the Auditor should make himself familiar with the mode of transacting business. Those interested in the subject are referred to the Authors' volume, entitled *Underwriters' Accounts*. The Underwriting Accounts are usually kept open three years, in order that all claims and other items may be included as far as possible in the year to which they relate, and enable the profit or loss in respect of each year's underwriting to be ascertained.

The Premium, Claim, Salvage and Re-insurance Books should be cast, and the totals checked to the Impersonal Accounts.

* * * Brokers' Ledgers should be examined, and the Balances checked, it being seen that the accounts are properly agreed from time to time, and that the differences written off are not excessive. The Agreement

between the Underwriter and his Agent, if any, should be examined, for the purpose of ascertaining the Agent's salary and commission, and for obtaining information as to how the charges are to be treated.

It should be seen that the accumulated premiums are duly invested in proper securities, and that the Trust Deed in respect thereof is in the form required by the Committee of Lloyd's. The existence of the securities should be verified. It should be seen that only profits actually ascertained have been withdrawn, any withdrawals in excess of this figure representing anticipations of profit which may not be earned, and in fact forming part of the accumulated premiums.

It may be remarked that, in order to comply with the requirements of the Assurance Companies Act, 1909, all Underwriters at Lloyd's are required to have their Accounts audited by a Professional Accountant approved by the Committee of Lloyd's, who must certify the result of his Audit to the Committee.

37.—Water Companies.

The Auditor should examine the Special Act of the Company, which will contain particulars relating to the Share and Loan Capital, and state the limit imposed on dividends. When no rate is prescribed, the limit is 10 per cent. per annum; but if in any year the divisible profits do not amount to the prescribed rate, such amount may be taken from reserve as may be necessary to make up the same. This reserve is formed under § 76 of the Water Works Clauses Act, 1847.

** The Audit of a Water Company follows to a great extent the procedure suggested in the case of Gas

Companies, described in § 17. The Water Rates are to a large extent dependent upon the rateable value of the properties supplied. The Laid-on Book should be checked with a certified copy of the Valuation List for Domestic supplies, and with applications and reports for extras; the consumption by meter with Meter Readers' Books and Contracts, if any, for special supplies; ship supplies, if any, with Turncock's Returns.

The allocation of expenditure as between Capital and Revenue should be examined, and it should be seen that this has been duly certified by the Company's Engineer.

SYNOPSIS OF CHAPTER XVI.

The Audit of Accounts of Local Authorities.

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2 — DISTRICT AUDITORS.

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5 — PROCEDURE AT AUDIT

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11 CAPITAL EXPENDITURE.

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13. — CORPORATION STOCK.

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CHAPTER XVI.

THE AUDIT OF ACCOUNTS OF LOCAL AUTHORITIES.

§ 1. -Classification of Auditors of Local Authorities.

The accounts of the Local Authorities of this country - which term is intended to include England and Wales, and Scotland - are subject to one of the following three classes of Audit, viz. :

- (1) By District Auditors appointed by the Local Government Board ;
- (2) By Elective Auditors ; or
- (3) By Professional Accountants, appointed by the Local Authority (in England), and by the Local Government Board or Secretary of State (for Scotland).

§ 2. -District Auditors.

The Local Authorities whose accounts are wholly or partly subject to Audit by District Auditors are, amongst others, County Councils, Metropolitan Borough Councils, Urban and Rural District Councils, Parish Councils, Parish Meetings, Guardians and Overseers of the Poor (including Sick Asylum Districts and Poor Law School Districts), Education Authorities (including Town Councils, as such), Port Sanitary Authorities,

and in a few cases the whole of the accounts of Municipal Corporations.

By the Poor Law (Amendment) Act, 1868, and the District Auditors' Act, 1879, it is the duty of the Local Government Board "to appoint such numbers of District Auditors as they may, with the sanction of the Treasury, think necessary, for the performance of the duties of auditing the Accounts, which are, for the time being, by law subject to be audited by District Auditors."

The majority of the persons appointed belong to the legal profession, and in consequence attention is given by them to the legality of the transactions, rather than to the ascertainment of the true financial position of the Authority concerned; but it is submitted that the Auditor should at the same time be empowered to insist upon the true financial position being shown, and be qualified to see that his request is complied with.

The Regulations for District Auditors vary slightly as between Poor Law Authorities and Sanitary Authorities, but the procedure at the Audit itself is practically identical. The Auditor may call upon all persons accountable, to attend, produce all books, documents, vouchers, &c., and require them to certify their correctness where he thinks it necessary. He must certify books and balances due, and Balance Sheets examined by him; and must report to the Local Government Board upon any irregularities. In the case of Urban and County Authorities and Borough Councils in London, he must also report to the Authority itself.

A Ratepayer who is aggrieved by any item in the Accounts under Audit may make an objection against it to the Auditor, who must receive and consider the

objection. The Auditor must then admit or disallow the item, and if required state in writing the reason of his allowance or disallowance.

The Auditor must disallow payments for which there is no legal authority, and surcharge them upon the persons responsible for the payment. This power is one that is often resorted to, but not often actually enforced; an appeal lying to the Local Government Board, who may reverse the surcharge, if improper, or remit it when it seems just to do so. A more drastic remedy is to take out a writ of *certiorari*, and by this means get the decision of the Auditor judicially examined and its legality determined. The decision of the Auditor can also be questioned by *certiorari*, on a question of fact; but the expense and trouble of proceeding by this method is such that it is not often adopted.

A surcharge which is not appealed against must be paid to the Treasurer of the Authority concerned; and if this is not done, the Auditor must recover the amount by legal process.

The District Auditor certifies as correct the Financial Statement, *i.e.* the Receipts and Expenditure Account, made up in the form prescribed by the Local Government Board, and allows the total amount of the expenditure specified in his certificate.

The remuneration of the Auditor is paid by the Local Government Board out of Parliamentary supplies, but a charge is made by means of an *ad valorem* Revenue Stamp impressed on the Financial Statement, and paid for by the Local Authority concerned. The charge is based upon the expenditure allowed after deducting therefrom payments made by the Authority under the precepts or Statutory demands of other Authorities.

Extracts from the various Statutes affecting District Auditors will be found in the Appendix.

§ 3. Auditors of Municipal Corporations.

There are three Auditors appointed annually under § 25 of the Municipal Corporations Act, 1882. Two of these are Elective Auditors, and the other is known as the Mayor's Auditor.

Elective Auditors are elected by the Burgesses, and the Mayor's Auditor is appointed by the Mayor. The only qualifications required are that an Elective Auditor must be capable of being a Town Councillor, but must not be a Town Councillor, Town Clerk, or Treasurer. The Mayor's Auditor must be a member of the Town Council.

Strictly speaking, the duties of the Auditors are to audit the Treasurer's Accounts: and where the Treasurer is the Banker of the Corporation, and not Accountant or chief of the Finance Department, it has been argued that this simply necessitates the Audit of the Bank Pass-book. In the Appeal Case of *Thomas v. The Deconport Corporation* (1900, 1 Q.B. 16), the Lord Chief Justice gave it as his opinion that something more than the Cash Audit was necessary, and that it was the duty of the Auditor to make a proper examination of the Accounts, so that he could report thereon to the Corporation. The Borough Auditors have no power of surcharge. They may, and very often do, report to the Burgesses, but there is no legal authority requiring them to do so. If illegal expenditure is incurred, the remedy is by a writ of *certiorari*, for the purpose of obtaining judicial review of the order for payment of the money out of the Borough Fund.

There is no remuneration allowed to the Auditors for the Audit of the Borough Fund ; but for the Audit of the District Fund, they are entitled to a reasonable sum, being not less than two guineas, for each day during which they are employed on the Accounts.

It may be said that this class of Audit is generally unsatisfactory, and it is not unusual for persons to accept the responsibility of the office who have not the slightest ability to carry out the duties attaching to the position. This is, of course, not always the case, but that the system is capable of improvement is confirmed by the report of the Joint Select Committee on Municipal Trading, June, 1903, which strongly recommended that the existing systems of Audit applicable to Corporations, County Councils, and Urban District Councils, should be abolished, and a Professional Audit substituted therefor.

The provisions as to Auditors contained in the Municipal Corporations Act, 1882, will be found in the Appendix, and apply to the Councils of County Boroughs and Non-County Boroughs in England and Wales, except where they are excluded by Special Statute, in which case Professional Auditors are appointed.

§ 4. Professional Auditors.

A large number of Municipal Corporations at the present time appoint Professional Auditors to undertake the Audit of their Accounts. Some of these make the appointment by authority of Special Act of Parliament, whilst others make the appointment without special or direct statutory authority. It has been suggested that to make such an appointment without special statutory authority is an illegal act, but those

Corporations which have done so have proceeded under § 19 of the Municipal Corporations Act, 1882, which runs as follows :—

“The council shall from time to time appoint such other officers as have been usually appointed in the borough, or as the council think necessary, and may at any time discontinue the appointment of any officer appearing to them not necessary to be reappointed.”

The work of Professional Auditors will, to a large extent, be guided by the contract which is made at the time of the appointment ; apart from this, it will also be influenced by the internal check which is in operation in the conduct of the Finance Department, and of the other departments, so far as financial matters are concerned.

In the Report of the Joint Select Committee on Municipal Trading, dated June, 1903, the Committee recommended that—

- (a) The existing systems of Audit applicable to corporations, county councils, and urban district councils in England and Wales be abolished.
- (b) Auditors, being members of the Institute of Chartered Accountants, or of the Incorporated Society of Accountants and Auditors, should be appointed by the three classes of local authorities just mentioned.
- (c) In every case the appointment should be subject to the approval of the Local Government Board, after hearing any objections made by ratepayers, and the Auditor, who should hold office for a term not exceeding five years, should be eligible for reappointment, and should not be dismissed by the local authority without the sanction of the Board.
- (d) In the event of any disagreement between the local authority and the Auditor as to his remuneration, the Local Government Board should have power to determine the matter.
- (e) The Scots practice of appointing Auditors from a distance, in preference to local men, to audit the Accounts of small burghs, should in similar cases be adopted in England.

§ 5.—Procedure at Audit.

The detail work which a Professional Auditor would find it necessary to perform in the course of

his duties, is very largely dealt with in other portions of this volume; in particular, however, it will be necessary for him to examine the system of Internal Check which is in operation in the Finance Department, and also the control which the Finance Department exercises over the financial transactions of other departments of the Municipality.

The principles upon which the Audit of a Local Authority should proceed, cannot be better stated than in the Report of the Joint Select Committee on Municipal Trading, of June, 1903, as follows :—

“The Committee are of opinion that it should be made clear by Statute or regulation that the duties of those entrusted with the Audit of local accounts are not confined to mere certification of figures. They therefore recommend that

- (a) The Auditor should have the right of access to all such papers, books, accounts, vouchers, sanctions for loans, and so forth, as are necessary for his examination and certificate.
- (b) He should also be entitled to receive from officers of the Authority such information and explanation as may be necessary for the performance of his duties.
- c) He should certify—
 - (1) That he has found the accounts in order, or otherwise, as the case may be ;
 - (2) That separate accounts of all trading undertakings have been kept, and that every charge which each ought to bear has been duly debited ;
 - (3) That in his opinion the accounts issued present a true and correct view of the transactions and results of trading (if any) for the period under investigation ;
 - (4) That due provision has been made out of revenue for the repayment of loans ; that all items of receipts and expenditure, and all known liabilities have been brought into account ; and that the value of all assets has in all cases been fairly stated.

Auditors should be required to express an opinion upon the necessity of reserve funds, of amounts set aside to meet depreciation and obsolescence of plant, in addition to the statutory sinking funds, and of the adequacy of such amounts.

The Auditor should also be required to present a report to the Local Authority. Such report should include observations upon any matters as to which he has not been satisfied, or which

in his judgment call for special notice, particularly with regard to the value of any assets taken into account.

The Local Authority should forward to the Local Government Board both the detailed accounts and the report of the Auditor made upon them. It should be the duty of the Auditor to report independently to the Board any case in which an Authority declines to carry out any recommendations made by him.

After careful consideration, the Committee are of opinion that, in view of the thoroughness of the proposed Audit, powers of surcharge and disallowance could be altogether dispensed with in the case of the major Local Authorities."

§ 6. Rates.

The principal Rates with which the Auditor is concerned are the Borough Rate and the General District Rate, these Rates being made by practically all Municipal Corporations; while the General District Rate is also the means of obtaining money by Urban District Councils for income purposes.

(a) Borough Rate.

The Borough Rate is assessed on the several Parishes in accordance with the assessable value of such Parishes, determined by—

- (a) Valuation List in force;
- (b) Last made Poor Rate; or
- (c) Council's own valuation.

When made, it is generally levied on the Overseers by means of a Precept, and collected by the Overseers with, and as part of, the Poor Rate. Any surplus in the Borough Fund derived from a Borough Rate must be applied as the Council direct, for the benefit of the inhabitants or improvement of the Borough. Any surplus *not* derived from a Borough Rate may be utilised for sanitary purposes, under the Public Health Act, 1875.

(b) General District Rate.

The General District Rate is based on a valuation in accordance with the Poor Law valuation for the time being in force, but certain hereditaments, including land, railways, canals, docks, &c., are assessed only on one-quarter of the rateable value. This rate is collected by the Council direct.

(c) Distinction between Borough and General District Rates.

The differences between the Borough and General District Rates are

- (1) The Borough Rate is generally collected with the Poor Rate, which is a separate rate for each Parish within the Borough or District, whereas the General District Rate is usually one General Rate for the whole area of the Borough or District.
- (2) The individual assessments differ to the extent that for the General District Rate, land, railways, canals, &c., are only assessed on one-quarter of the rateable value; whereas, in the case of the Poor Rate (including the Borough Rate), agricultural land is chargeable with half only of the rate in the £ charged on other hereditaments, the loss of revenue to the Parish on this head being largely made good through the Local Taxation Account.
- (3) The provisions for the compounding for the payment of rates differ.
- (4) The Borough Rate is applicable to civil purposes, and the District Rate is applicable to sanitary purposes.

In the case of many Local Authorities, a joint collection has been instituted for the Poor Rate and

the General District Rate ; but for the reasons mentioned they must be kept entirely separate and distinct, even if collected on one demand by the same Collector.

(d) **Audit of Rate Accounts.**

The following procedure is necessary in auditing the Rate Accounts :

(1) *Borough Fund.*

See the resolution of the Council for the amount raised and levied on the Overseers by precept, vouching same into the Ledger Account of the Overseers. See that the amounts are received at the proper dates and in proper instalments.

(2) *District Fund.*

Examine the Rate Books. See that they are properly headed, signed, and sealed with the seal of the Authority. Compare total of assessable value with the copy of Valuation List as supplied by the Assessment Committee. Check reductions of assessment and allowances. For those which are made by Statute, the rateable value will be reduced, in other cases an allowance will be made. These allowances must be *intra vires*, and should be supported by Special Resolution of the Council, passed on a recommendation of the Finance Committee. Examine Supplemental Valuation Lists for alterations. Check the Summary of the Rate Account, and prove in total. Check the collecting and deposit books of the collectors, with the receipts issued by them, and with payments made to Treasurer by them. See the Ledger Accounts are properly kept for each collector.

Neither of these rates must be made in respect of expenditure incurred anterior to a period of six months before its allowance.

§ 7. --Other Income.

Income will be received from various sources, such as Baths and Wash-houses, Markets, Allotments, &c. It should be seen that a proper system of Internal Check is in force for these receipts, and the same should be thoroughly tested.

§ 8. --Payments.

Especial care is generally exercised in dealing with accounts for payment. The ordinary course of procedure with regard to invoices, as already described in this book, will apply, so far as the department concerned with the ordering of the goods is affected. The requisition books should be examined, and checked with invoices. The invoices will then pass to the Finance Department, where they will be checked as to accuracy, and to see that the proper routine has been gone through in the ordering department. It will also be observed that contract prices are adhered to. They are then certified as correct by the Chief of the Finance Department, and placed before the proper Committee, where, if approved, they are signed by the Chairman of that Committee. Subsequently they will be placed before the Finance Committee, and signed by the Chairman of that Committee; after which they will be presented to the Council for payment.

The Auditor should see that the Internal Check on these matters is properly carried out, and in vouching the various payments will see the Minute Books of the Council and its Committees; examine the invoices relating to each department to see that they are properly

signed ; observe that they are paid out of the Fund to which the expenditure is properly chargeable ; and note that all payments are within the powers of the Corporation, and covered by some estimate.

By § 9 (1) of the London Government Act, 1899, it is provided that “ . . . all payments by the Council shall be made in pursuance of an Order of the Council, signed by three members of the Finance Committee present at the meeting of the Council . . . and the same Order may include several payments.” This provision is also to be found in the Local Government Act, 1888, § 80, and a similar provision (except as regards the Finance Committee membership) is embodied in § 141 of the Municipal Corporations Act, 1882. The Order referred to does not mean an order cheque, but is a list of the payments which the Council authorize the Treasurer to make on their behalf. This list is a great protection against fraud by altering the amount of any cheque or by any person forging a cheque, for the reason that the identical amount of the cheque must appear on the order sheet, together with the name of the person to whom it is payable.

§ 9.—Outstandings.

It is not absolutely necessary for Municipal Corporations to keep their accounts on income and expenditure lines, but from the fact that a great number do this it is evident that the purely cash system of account-keeping is considered inadequate ; and it may be noted that the adoption of the Income and Expenditure system was recommended by the Departmental Committee on Local Authority Accounts.

Apparently the Auditor cannot insist on Outstandings being brought in, but he should certainly recommend that such a course should be adopted. It should be noted, however, that the returns to be made to the Local Government Board are in respect of receipts and expenditure only.

Much has been said and written as to what the term receipts and expenditure really means, and in actual practice among Municipal Officers each one defines it as meaning that which best suits his convenience. When it was first used by the Legislature it was presumably intended to cover receipts and payments only, but as the work of the Municipalities has increased, and in particular as Municipal Trading has grown, the necessity for Income and Expenditure in accounts has led to an altered definition of the term. It should be noted that the Local Government Board always accept returns of Income and Expenditure without question.

§ 10. - Exchequer Contributions and Grants in Aid.

These consist of amounts paid to Local Authorities out of Imperial Revenue (Local Taxation Account), in respect of services which are permanently national in character, though locally administered. Such sums are derived from--

- (1) Local Taxation Licence Duties (Local Government Act, 1888, § 20).
- (2) Estate Duty on Personalty (Local Government Act, 1888, § 21, as amended by the Finance Act, 1894).
- (3) Local Taxation (Customs and Excise) Duties Act, 1890.

Moneys credited to the Exchequer Contribution Account must be applied by the County or County Borough concerned, in accordance with the provisions of the Local Government Act, 1888, and the Education Act, 1902.

Local Authorities also receive grants in aid of Public and Elementary Education; and grants from the Crown in lieu of rates in respect of Crown Property within the local area.

The Auditor should see the published accounts, correspondence, &c., relating to any of the above, and should see that they are applied in accordance with law. Where any sums are brought into account before receipt, the basis on which apportionment has been made must be examined, and certified by the responsible persons concerned.

§ 11.--Capital Expenditure.

In the execution of their Statutory duties Local Authorities have to expend—from time to time—large sums of money for what are generally termed Capital purposes.

This expenditure may be grouped under two distinct heads:—

1. Productive Works, *e.g.* Undertakings for supplying light, water, transit, markets, &c.
2. Non-productive Works, which can be further divided into--
 - (a) *Realisable*, such as Town Halls, Public Libraries, Depôts, &c.
 - (b) *Unrealisable*, such as Street Improvements, Sewerage, &c.

The benefits derived from this expenditure are in all cases enjoyed for a considerable period, and an endeavour is made to make an equitable charge upon the ratepayers in respect thereof over such period. In practice this is not effected, for the reason that it is impossible to ascertain exactly the life of the works so carried out ; and secondly, it is essential that Local Authorities should be required to repay all borrowed money within fixed periods.

The sanction of a Government Department is (practically in all cases) a necessary preliminary to borrowing money for such purposes, and the periods for repayment vary considerably under different Statutes. The instrument authorizing the borrowing always states the period during which the money has to be repaid.

Local Authorities often obtain special borrowing powers by Local Act, but in these cases it frequently happens that the Act first gives power to take over a concern already formed, or establish a particular business, and in addition prescribes the amount of money that may be borrowed for the purpose, and the period within which such money has to be repaid. In such cases it is possible to obtain a longer period for repayment than is prescribed under general Statute.

The distinction between Loan expenditure and Capital expenditure must be properly understood. Thus, certain items which are properly chargeable to Capital Account cannot be paid for out of borrowed money, owing to the restrictions of the sanctioning authority, and on the other hand many assets are acquired in respect of which no loan has been obtained. It will be the duty of the Auditor to see that such assets are duly recorded, so as to obviate the possibility

of their being lost sight of. The Auditor should make himself conversant with the local and general Acts of Parliament affecting the borrowing powers of the Authority whose accounts are being audited, and also the various methods by which the Authority is empowered to exercise such borrowing powers.

Another important point is to see that money borrowed for a particular purpose is applied to that purpose. It frequently happens that the Authority, having decided to do a certain thing, experiences some difficulty in obtaining sanction, and that before the sanction is actually received some expenditure is incurred in anticipation. In such a case the provision for repayment should commence from the date of the completion of the works, and not from the borrowing of the money.

It may be advisable here to mention that money borrowed from the Bank to meet an overdrawn loan account, whether the overdrawn balance is due to excess expenditure over the estimate, or for any other reason, is, in the absence of authority to borrow, equivalent to an illegal borrowing. (*Attorney-General v. Corporation of West Ham*, 1910, Acct. L.R. 41.)

The Auditor's duties in connection with vouching Capital expenditure have been considered in Chapter II.

§ 12.--Raising Capital Moneys.

The principal methods adopted for the raising of loans are the following:--

(a) By Issue of Stock.

* This method is resorted to under Statutory power, very frequently by virtue of a Local Act, and has grown

very popular of late years, increased facilities having been made for its adoption. Its advantages will be referred to later. The money obtained by the issue is based either upon a fixed price of issue, or upon tenders with a fixed minimum price. The issue being thrown open to the public, and the security being good, a large sum may frequently be raised more cheaply in this way than by any other method. Matters relating to the issue of Corporation Stock are dealt with in § 13.

(b) By Granting Mortgages upon Property and Rates

This is a very general method of raising funds utilised by Local Authorities who do not or cannot resort to Stock issues. Mortgages granted by Local Authorities may conveniently be classified as follows:—

(1) Those granted for actual period and amount of specific sanction

- (a) Providing for repayment at any time after stated period after notice by either party ;
- (b) Providing for repayment at a fixed date ;
- (c) Providing for repayment by periodic instalments.

(2) Those granted for short periods --

- (a) Fixed period (*e.g.* five years) ;
- (b) Providing for repayment after six months' notice by either party ;

which in either case may be allocated to sanctions after the money has been actually received,

The first method is usually adopted by the smaller authorities (*e.g.* District Councils and non-County Borough Councils), the loans being obtained from

Insurance Companies, who make a practice of advancing funds to Local Authorities : from other Local Authorities, who find this a convenient and safe method of investment for their redemption funds ; or from the Public Works Loan Commissioners, who exist for the purpose of lending to Local Authorities money raised on the national credit.

One disadvantage of this system is that the rate of interest is fixed for a long period. Borrowing by this means is authorized by almost all the Statutes conferring powers of borrowing ; but such Statutes only allow the particular Rate concerned to be charged. In some cases, however, power has been obtained by Local Acts for Mortgages to be issued and secured indifferently on all the Rates, Revenues, &c., of the Authority concerned.

The second method of raising money is often adopted by the larger Authorities, to provide money temporarily, pending an issue of Stock ; and, if loans are received in small sums, it furnishes a source of investment for private individuals, locally interested.

Under this system advantage can generally be taken of better conditions prevailing in the money market by paying off the loans and reborrowing. There is the risk, however, of a large number of Mortgagees calling in their Mortgages under similar circumstances, which might cause the Local Authority inconvenience.

(c) By Issue of Bills of Exchange.

This is done by Corporations of the largest towns, principally for the purpose of meeting capital expenditure pending an issue of Stock. The power is conferred only by Local Act.

(d) By Issue of Debentures, Debenture Stock or Terminable Annuities under the Local Loans Act, 1875.

* These methods are very little resorted to, as the Act does not itself confer the power to issue Stock, and some of its provisions are defective, whilst others are not considered satisfactory; *e.g.* Debenture Stock cannot be issued for larger nominal amount than the borrowing power; Loans rank according to priority of date of issue, &c.

§ 13.—Corporation Stock.

Corporation Stock is a marketable commodity representing a combination of liabilities to individuals who have advanced money in response to a public invitation, or acquired the rights of others who have done so, secured without discrimination upon all the Rates, Revenues, and Property of the Issuing Authority.

Where large sums are required for capital purposes, and the market conditions are favourable, this method of borrowing is probably the best, for the following reasons:—

- (1) Recourse being had to the open market, and the security being usually regarded as excellent, the money is generally obtained, even when the Stock is issued at a discount, on more favourable terms than by any other method.
- (2) The period for redemption is a lengthy one, sixty years being generally allowed, with an option to call in any or all of the Stock after the expiration of a stipulated period, usually twenty years. (It must be remembered, however, that provision for redemption of Stock

must be made within the periods of the sanctions concerned.)

- (3) The administrative advantages are particularly important, all interest being at the same rate upon the particular issue, and falling due at the same date, and the same method of payment thereof being adopted.
- (4) An investor may take up a small amount of the Stock, and may at any time sell all or part of his holding, the transfer of the Stock being allowed in multiples of, say, £1, in excess of a stipulated minimum amount, commonly free of transfer duty.

It has been stated that the Local Loans Act, 1875, does not of itself give the power to issue stock and the Act is therefore of very little importance so far as stock is concerned. Some Local Authorities have obtained authority to issue stock by means of Local Acts, which must be referred to for regulations governing the issue. Up to 1882, the regulations concerning the issue of stock in different Local Acts were dissimilar and defective in some respects, but in this year Model Stock Clauses were drawn up and have been incorporated in all Local Acts passed since 1882. It is not proposed to consider these model clauses in detail, as they are very similar to those incorporated in the Stock Regulations mentioned hereafter.

Redeemable Stock may be issued, apart from local legislation, by County Councils in accordance with 70 of the Local Government Act, 1888 ; and by Urban Sanitary Authorities under Part 5 of the Public Health Acts (Amendment) Act, 1890, where that portion of the Act has Authority concerned.

Regulations have been issued by the Local Government Board under these Acts, which are known respectively as the County Stock Regulations of 1891, 1897 and 1901, and the Stock Regulations of 1891, 1897 and 1901.

The Regulations are very similar, and provide, *inter alia*, as follows :

- (1) The Local Authority (except County Councils) must obtain from the Local Government Board a "Consent Order" authorizing the issue of Stock; upon receipt of which the Local Authority may from time to time by resolution create and issue redeemable stock up to the amount of the statutory borrowing powers mentioned in such order.
- (2) Stock may be issued at a premium, at par, or at a discount not exceeding (except with the consent of the Local Government Board) 5 per cent.
- (3) The Local Authority may issue more than one class of stock, but all issues of a particular class must be subject to the same terms and conditions, except that the price of issue may vary.
- (4) Sufficient stock may be issued to produce the actual sum raisable (*i.e.* including expenses of issue and discount).
- (5) The Local Authority must establish a separate "Stock (Dividends) Fund" for every class of stock, to which must be paid in each year a sum equal to the aggregate amount of all dividends payable on such stock drawn from the appropriate funds or revenues in propor-

tion to the stock allocated thereto Payments into the Dividends Fund of—

- (a) Rents and profits of land and other property acquired for purpose in respect of which stock has been issued,
- (b) Dividend Contributions,
- (c) Unclaimed Dividends,

must be recorded so as to distinguish amounts applicable to each undertaking and purpose.

- (6) The Local Authority must establish a separate "Stock (Redemption) Fund" for every class of stock, to which must be paid in each year a sum equal to the aggregate amount payable for redemption and extinction, or purchase and extinction, of stock, drawn from the appropriate funds or revenues concerned. All amounts in the redemption fund must, until actually applied in the redemption or purchase of stock, be invested in statutory securities; and separate account of such kept. The annual proceeds from the securities are to be paid into the Redemption Fund (or to the Revenue Account concerned, if the Redemption Fund is non-accumulating).
- (7) The Local Government Board are empowered to approve schemes for consolidation of loans, and subject to this, provision is made for paying off existing securities with moneys raised by stock, or for the issue of stock in substitution for mortgages or other securities. The consent of the holder is in most cases necessary for this latter procedure, and Local Authorities are authorized to pay such holders reasonable

• compensation and issue stock up to the amount paid.

• In connection with each Fund separate accounts are to be kept in respect of each undertaking or purpose, and of each statutory borrowing power.

The method of ascertaining the amounts due to the Stock (Dividends) Fund from each of the Corporation Funds for interest is of course a simple calculation.

To ascertain what is due to the Stock (Redemption) Fund for debt redemption purposes, reference must be made to tables, from which the sum annually required to redeem £1 under given conditions can be obtained; and the sum so obtained must be multiplied by a figure equal to the amount of the particular debt to be redeemed, the result being the annual contribution to the Stock (Redemption) Fund. The Auditor should check these calculations.

As has been stated, the Corporation generally has power after a definite period has elapsed to call in any or all of the Stock. It will depend upon circumstances as to whether it is advisable to take advantage of this option, the principal factors in the case being the market price of the Stock to be bought in, and the rate of interest earned upon the investments which must be realised to enable this to be done. Where advantage is taken of a favourable opportunity to cancel a parcel of Stock, it must be borne in mind that the Sinking Fund contributions will not be affected, but will have to be regularly made for the whole period upon which Sinking Funds have been calculated, interest accumulations being made good out of Revenue.

As a general rule, Local Authorities are not empowered to utilise ordinary Sinking Fund accumula-

tions for their own Capital purposes, but by Article 2 of the Stock Regulations Amendment, 1901, they are so empowered in regard to Redemption Funds provided for redemption of Stock.

Several Local Authorities have obtained power under Local Acts to utilise for their own Capital purposes Sinking Funds established for repayment of loans on mortgage, &c., in addition to redemption funds provided for redemption of Stock. The question as to the advisability of so using Sinking Funds was recently considered by a Select Committee of the House of Commons, who reported that such utilisation in lieu of borrowing is financially unobjectionable if properly safeguarded and certain conditions imposed. The Sinking Fund Investments must be verified by the Auditor.

The Auditor's duties in vouching an issue of Stock are similar to those in connection with vouching an issue of Share Capital which have been dealt with in Chapter IX., § 2.

§ 14.—Repayment of Capital Moneys.

Local Authorities usually repay borrowed moneys by one or more of the following methods :—

- (1) Equal yearly or half-yearly instalments of principal, with interest on the balance from time to time outstanding. This is known as the Fixed Instalment System, under which the total annual payment decreases each year, and the burden falls heavier upon the ratepayers in the earlier years of the currency of the loan.

- (2) Equal yearly or half-yearly instalments consisting of principal and interest combined, resulting in an equal annual charge to the ratepayers during the currency of a loan. This is known as the Annuity System. The total interest payable on a particular loan is, however, greater than would be the case under the Fixed Instalment System.
- (3) By means of a Sinking Fund. This method is very generally adopted, owing to the fact that in the absence of binding conditions moneys may be raised for short periods and in small sums, and loans may be redeemed and reborrowed on more advantageous terms ; also that the terms for borrowing are generally more favourable than under the other systems of repayment owing to the whole sum borrowed being repayable in one amount, while in addition the fund may be applied in repayment of debt at any time where conditions are favourable. The administration of Sinking Funds, and the method of accounting is naturally more complicated than in the case of repayment by instalments.

Provision for the redemption of Stock can only be made by this method. The Stock Regulations of 1891, 1897 and 1901, provide for Redemption Funds of two kinds : -

- (1) Accumulating (analogous to the Annuity System) under which interest on investments is credited to the Fund as well as the periodic contributions.
- (2) Non-accumulating (analogous to the Fixed Instalment System) under which interest is credited to the Revenue Account concerned.

The Auditor must see that redemptions of Stock are in accordance with the terms of issue. The cancelling entries in the Stock Register should be checked, and if Stock is purchased in the open market, bought notes should be seen.

In the case of repayment of Mortgages there should either be a reconveyance of the property charged, which should be seen, or the Mortgage Deed itself, with a discharge endorsed thereon by the Mortgagee, should be produced.

In the case of Bills of Exchange the cancelled Bill should be produced.

§ 15. Depreciation of Capital Assets.

It has been previously stated that in all cases where Capital is raised, authority to do so must have been obtained from a Government Department, and when this authority is given, a term is fixed during which the amount borrowed must either be repaid, or provision made for that purpose, out of Revenue.

This is all that is directly required by law ; and at the end of the period for which the loan was sanctioned, if the sum borrowed has been entirely repaid, the Local Authority is entitled to reborrow for the original purpose, again obtaining sanction of the proper Government Department.

In the case of trading undertakings, *e.g.* Gas, Electric Light, Water, Tramways, &c., the Local Authority acquiring powers to carry on such undertakings possesses the monopoly of supply over the area to which such powers relate, and in consequence is compelled by law to give a supply to every person demanding it, heavy penalties being imposed where any

such demand is not complied with. For this reason the undertaking must be kept in such a condition as to be able to meet the demand, and this will naturally necessitate provision for depreciation being made to a certain extent.

Small replacements which take place frequently will be charged against Revenue, as and when the expenditure is made; but larger replacements should be dealt with by the creation of a specific or general reserve or renewal fund, as otherwise the charge for such larger replacements would be excessive as against any particular year's Revenue.

Where the asset requiring replacement forms part of a group of assets acquired under one sanction, provision must be made for the redemption of the whole debt upon such group of assets, before re-borrowing can be resorted to in respect of all or any part of such group. Where such replacement becomes necessary, it is essential that the accumulated sinking fund, together with the break-up value of the original assets, should provide for the total redemption of the debt upon such assets, and if a reserve fund has not been created for the purpose of meeting any deficiency, such deficiency will have to be met out of the rates of the Local Authority before a new loan can be sanctioned.

Much discussion has taken place on the subject as to whether it is necessary to provide for depreciation of fixed assets employed in trading undertakings, in addition to the statutory provision for the repayment of debt. The importance of this question turns upon the fact that it is only profits derived from carrying on a trading undertaking that can be applied in relief of the rates.

It has already been pointed out that the Authority must maintain the assets in a state of efficiency, in order to continue to be able to supply the commodity, and that it is not entitled to reborrow, for the purpose of replacement, until the original loan, by which the assets were acquired, has been repaid. Consequently, the current cost of maintenance must be charged against Revenue.

If provision for depreciation is made on such a scale as to enable replacement to be made out of Revenue, when the assets require renewal, in addition to provision for the repayment of debt out of Revenue, the result will be that when the debt has been repaid the then existing generation of ratepayers will be in possession of a fully equipped undertaking, and will not be obliged to have recourse to borrowing for the purpose of carrying it on.

This is the highest point of view, but it is very rarely carried out in practice, and cannot be said to be legally necessary.

There would appear to be no obligation, by Statute or otherwise, for the present generation of ratepayers to do more than repay the loan, and maintain the undertaking in a state of efficiency out of Revenue, making the necessary provision where the assets or any part of them will require renewal before the expiration of the loan period. This should be made before the ascertainment of profits available for relief of the rates, and the Auditor should arrive at an opinion as to whether this has been done before any profits are transferred.

It is sometimes contended that all that is necessary is to provide for current maintenance, and for the statutory charges for repayment of debt, leaving the

question of reserve for renewals, prior to the expiration of the loan period, to be dealt with as they arise. This, however, is unsound in principle, and the contention that the goodwill being created can be regarded as counterbalancing any deficiency in assets arising in this manner is not one that can be admitted by the Auditor.

The question of loss arising from obsolescence has assumed much prominence in recent years, and it has been contended that the ascertained loss arising from the conversion of the whole or a portion of the undertaking, owing to improved methods of production or means of transit, should be provided for out of Revenue at a more rapid rate than the statutory provision for the repayment of the original loan requires. Although this may be desirable, it cannot be regarded as essential in cases where fresh borrowing powers have been granted expressly for the purpose of conversion without such a condition being imposed.

Loss occasioned by obsolescence of minor portions of the undertaking should be regarded as a Revenue charge, and where such obsolescence can be reasonably foreseen, the same should be provided for.

In connection with non-trading undertakings, it is sufficient for the Auditor to see that proper provision for repayment of debt is made each year.

§ 16.—Statutes and Bye-Laws.

It must be borne in mind that the Auditor must be thoroughly acquainted with the Statutes governing the particular Local Authority he is concerned with, and he must in addition understand the bye-laws of the Council, especially those dealing with financial matters.

Finance Committees are only Statutory Committees in the case of County and Metropolitan Borough Councils, by virtue of the Local Government Act, 1888, and the London Government Act, 1899, which provide that such Committees shall regulate and control the finance of the Local Authority, and indicate the procedure therefor. Most Authorities, however, appoint Finance Committees, and by their bye-laws often regulate the administrative details by which they are to exercise full financial control. The Auditor should see that the bye-laws in this respect are properly complied with.

Extracts from various Statutes affecting Local Authorities will be found in the Appendix.

SYNOPSIS OF CHAPTER XVII.

Investigations.

- § 1 THE NATURE OF INVESTIGATIONS
- 2 INVESTIGATION ON BEHALF OF A PROPOSED COMPANY.
 - (a) The extent of the Investigation.
 - (b) Course of Procedure
 - (c) The usual Adjustments necessary
 - (d) The Certificate of Liabilities
- 3 —OTHER INVESTIGATIONS
- 4 INVESTIGATIONS FOR FRAUD

CHAPTER XVII.

INVESTIGATIONS.

§ 1. The Nature of Investigations.

The term Investigation implies an examination of the Accounts of a business for some special purpose. It differs from an Audit, inasmuch as it is not primarily carried out for the purpose of ascertaining whether the Balance Sheet of the business is properly drawn up, but rather for the purpose of obtaining expert information as to the earning capacity and financial position of the concern, from some special point of view, usually that of an intending purchaser or investor; or, in the event of fraud, for the purpose of ascertaining the extent thereof. The various classes of Investigation carried out in practice are too numerous to be dealt with here, but the following may be indicated:—

- (1) On behalf of the Vendors to, or promoters of, a proposed Company, with a view to the preparation of a Certificate of Profits for insertion in a Prospectus.
- (2) On behalf of a private individual or firm about to purchase a business.
- (3) On behalf of a prospective incoming Partner.
- (4)* On behalf of an individual or firm proposing to finance a business by advancing money to the Proprietors, or taking up Shares or Debentures in a Private Company.

- (5). On behalf of a Shareholders' Committee of Investigation.
- (6) On behalf of the Proprietors of a business where fraud is suspected, or known to have taken place.

The Accountant asked to investigate should obtain written instructions from his client as to the period to be covered by the Investigation, and the purpose for which it is required; but as he is consulted as an expert, he must himself decide the extent to which the Investigation should be carried, having regard to the information which he may consider will be of importance to his client, and to the manner in which his Certificate or Report will be utilised.

§ 2. —Investigation on behalf of a Proposed Company.

(a) The Extent of the Investigation.

The Accountant, employed by the Vendors to or Promoters of a Company for the purpose of examining the Accounts of a business proposed to be acquired, with a view to giving a Certificate of Profits for insertion in the Company's Prospectus, should remember that he is not only responsible to his clients for the work he performs, but also bears no small responsibility towards the public, since on the faith of his Certificate as an expert the public will be asked to subscribe for shares in the Company. It is important, therefore, that the Accountant should ascertain, as far as he can, the *bona fides* of all parties interested in the matter, since, in the event of the new Company proving unsuccessful, and legal proceedings being taken, he is bound to find himself involved in the matter. For this reason

it is essential that he should retain a complete record of all material information, and of the manner in which he has arrived at the figures he ultimately certifies, so that he may be in a position to substantiate his Certificate, if called upon to do so.

The length of the period to be investigated will be determined by the parties instructing the Accountant, although his opinion may be asked on the point. Usually, where a Trading business is to be acquired, the Certificate covers a period of three, five, or seven years. The object of the Investigation is to arrive at the normal Trading profits during the period, and the Accountant should strictly confine himself to ascertainable facts, and not indulge in calculations or problematical estimates of future operations.

Where the books of the business have been properly kept, and regularly audited by Professional Accountants, the work of the investigating Accountant will be materially facilitated, and he is reasonably entitled to assume that the books are arithmetically correct. Where, however, the Accounts have not previously been Audited, it may be necessary for details to be examined rather more fully.

(b) Course of Procedure.

Assuming annual Accounts to have been prepared, and the books regularly balanced, the first thing for the Accountant to do will be to obtain as complete a view as possible of the transactions during the period covered by his Investigation, and the most convenient method of doing this is as follows:—The Trading and Profit and Loss Accounts for each year should, if necessary, be redrafted on a uniform basis, so as to afford a ready means of comparison between one

year and another. When this has been done, the Accounts should be entered up in columnar form, a column being provided for each year, and a space being left against each column, for the purpose of inserting the percentage of each class of expenditure in relation to the turnover. The Balance Sheets should be set out in a similar manner, and from a comparison of the various figures and percentages, much valuable information will be afforded, which will be of material assistance in the course of the Investigation.

In examining the Trading Accounts, it should be seen whether the ratio of gross profit is constant, or whether it is subject to much variation. In the latter case, the cause of the variation must be ascertained, since, if it is not due to the rise or fall in the cost of materials, increase or decrease in wages or other manufacturing expenses, or variations in selling price, it will probably be found to be due to errors, or inflation in the values of the Stocks. The Stocks at the end of each period should be compared, and it should be seen whether the total Stock held tends to rise or fall in relation to the turnover. If there is a considerable increase in the Stock held, without a corresponding increase in trade, this may be due to inflation of values. A comparison of the turnover of each period should be made, for the purpose of ascertaining its progression, and the cause of any abnormal variations.

The various classes of expenditure relating to each period should be compared, and any fluctuations in the percentage they bear to the turnover enquired into. A comparison of the Accounts in this manner will indicate any special expenditure incurred in any year in excess of the normal, as, for instance, in the case of advertising.

A comparison of the Balance Sheets will afford information as to the amounts annually taken credit for in respect of the various classes of fixed assets, outstanding debtors, reserves for bad debts or discounts, cash balances, and items of expenditure carried forward, if any. The amounts due to trade creditors should be compared, and any variation in the Capital employed in the business noted.

Having obtained all the information available in this manner, the Accountant will be in a position to decide as to the extent of his examination. The opening Balance Sheet should be checked. The Impersonal Ledger should be examined, all the totals from subsidiary books being checked thereto, and cash postings tested. The nominal balances should be checked at the end of each year to the Profit and Loss Accounts.

As regards vouching, it is not usually considered necessary for the Accountant to vouch the payments, even where no Audit has been previously performed. The object of the Investigation is to ascertain profits, and the Accountant is not concerned with the manner in which the payments have been made, or whether they can be satisfactorily vouched. It is, however, important that all Capital expenditure should be vouched, since if this is done all remaining expenditure must be of a Revenue nature.

The asset accounts in the Impersonal Ledger should, therefore, be checked in detail, and all Capital expenditure vouched, care being taken to see that it is properly chargeable to Capital, and is not expenditure, in the form of repairs and renewals, which should have been charged to Profit and Loss.

The Stock Sheets should be examined and tested,

and it should be seen that they have been duly certified, and that the basis on which prices have been taken is uniform throughout the period, being either at or under cost. If Stocks have been taken above cost, or insufficient depreciation has been allowed for spoiled or obsolete Stock, adjustments must be made accordingly.

It should be ascertained that the sales do not include goods out on sale or return, in the hands of Agents, or on consignment. If transactions of this nature have been improperly recorded the necessary adjustments must be made in order to eliminate from each year's accounts the profits in respect thereof.

As regards expenses it should be ascertained as far as possible that all outstanding liabilities at the end of each year have been brought into account, special attention being paid to any items that disclose undue variation. The method upon which bad debts have been provided for should be ascertained, and the Debtors' balances at the close of the period checked in detail with a view to ascertaining that sufficient provision has been made.

The Accounts for the last year of the period should be examined in rather greater detail, particularly where the profit has increased, since it is possible that manipulations may have been carried out with a view to increasing the profits of the last year. This might be done by inflation of the closing Stock,² the inclusion of fictitious sales,³ the omission of purchases or other outstanding liabilities, by reduction in the provision for bad debts or depreciation, by starving the business by an excessive reduction in expenses, or by paying business liabilities out of private moneys. A comparison of the figures in the manner previously indicated should enable the Accountant to detect any variation

that might be due to one or other of the above causes.

In the event of sales during the last few months of the closing year showing a considerable increase, with a corresponding increase in the outstanding debtors, the sales should be tested with the Order Books and Goods Issued Book, in order to ascertain whether they are *bonâ fide*. If necessary the accounts of the succeeding period should be examined to see that no excessive returns or allowances have been put through to cancel the sales entered up in the previous period. In order to ascertain whether purchases have been omitted the Goods Received Book for the close of the period should be tested with the Bought Journal. The reasons for any marked decrease in expenditure should be ascertained.

The closing Balance Sheet should be checked in detail.

(c) **The usual Adjustments necessary.**

Assuming the Accountant has investigated the Accounts as far as he considers necessary and is of opinion that they are correct, there will, nevertheless, remain a considerable number of adjustments to be made before the profits can be arrived at for the purpose of inclusion in the Prospectus. The object of the Certificate is to afford intending investors information as to the earning capacity of the business in the past from which they can draw their conclusions as to its probable earning capacity in the future. For this reason, although the Certificate should deal with past facts, it is necessary to adjust the profits of the business to the conditions that will obtain in the case of the Company.

It will usually be found necessary to add the following items to Profits :

- (1) Interest on Partners' Capital and Current Accounts, Partners' Salaries, and Income Tax, if any, as these are appropriations of profit.
- (2) Interest on loans and overdrafts, if any, except where any of the loans will be taken over by the Company; otherwise it is to be assumed that the Company will be provided with sufficient working Capital, when such charges will not be incurred.
- (3) Rent, if the Company is going to purchase the trade premises hitherto rented by the business.
- (4) Discount on purchases, where owing to lack of working Capital the business has not been able to avail itself of all discounts, and it is expected that the Company will be in a position to do so.
- (5) Exceptional losses, such as those arising by reason of insufficient insurance, although in such cases the full insurance premiums should be charged; defalcations; costs and damages incurred by actions at law, and other losses not arising in the ordinary course of business.
- (6) Capital losses, such as loss on sale of fixed assets, or investments.
- (7) Any additions or improvements of a Capital nature that have been charged to Profit and Loss.
- (8) Any excessive reserves for bad debts or other contingencies.

The following items should be deducted from the Profits :—

- (1) Income from assets not being taken over by the Company.

- (2) Rent, if no charge has been made for this in the Profit and Loss Accounts, and the Company is not going to buy the premises.
- (3) Exceptional profits, such as compensation for compulsory removal of premises, insurance profits, speculation profits.
- (4) Capital profits, such as profits on investments, or on sale of fixed assets,

The question of depreciation is a difficult matter to deal with. It is preferable for the profits to be stated after providing an adequate amount for depreciation, if this can be arrived at, but, inasmuch as the values upon which the Company will base its provision for depreciation will in most cases materially differ from the values in the books of the Vendors, it is clear that unless the rates of depreciation are based upon the new values the inclusion of charges for depreciation that may have been sufficient in the past will be misleading. In other cases difficulty may be experienced in arriving at a proper rate of depreciation having regard to the nature of the assets. Where full provision cannot be made as above indicated, the actual charges for depreciation should be added to the profits, and the Certificate should clearly indicate that depreciation has not been provided for.

(d) The Certificate of Profits.

The Certificate of Profits should be worded in a clear and unambiguous manner, and the precise periods covered by the Investigation set out. Where the adjustments made are merely of an ordinary nature it is sometimes thought sufficient to say that all the adjustments necessary in the opinion of the Accountant have been made, but where such adjustments involve

special items of importance these should be specifically referred to. It is much to be desired that the profits for each year should be set out separately, particularly where the profits tend to decrease, since an average Certificate given under such conditions might be regarded as misleading. As already indicated it is important that the Certificate should be confined to questions of fact and not deal with matters of estimate or opinion.

§ 3.—Other Investigations.

Many points arising in connection with the other classes of Investigation referred to in § 1, have been dealt with in the preceding section, but there are some special points which require further consideration.

The Accountant investigating on behalf of a private individual or firm about to purchase a business, should enquire into the class of business carried on by the Vendors, and ascertain whether a fair return is likely to be obtained on the purchase price.

If investigating on behalf of a prospective incoming partner, the Accountant should include in his report all information which comes to his knowledge that may be of importance to his client in arriving at a decision as to whether he shall continue the negotiations. The Accountant should be informed of the proposed terms of partnership, in order that he may be in a position to advise his client as to whether he considers them to be reasonable or not. He should also ascertain, as far as possible, the reason why the firm wish to take in a new partner, as this may be due to financial weakness. Any indication of financial difficulties involving one of the partners, should also be reported.

The valuations placed upon the assets of the firm should be enquired into as if such assets are over-valued, the capitals of the partners will be inflated, and the incoming partner might be prejudicially affected in the event of dissolution.

Where an investigation is being made on behalf of an individual or firm proposing to finance a business, by advancing money to the proprietors, or taking up shares or debentures in a private Company, the Accountant should ascertain the reason why the additional capital is required, and satisfy himself that it can be profitably employed.

In the case of a Company, it should be ascertained whether any Reserve Account or Reserve Fund exists, and whether the assets are inserted in the Balance Sheet at a proper value. Any fictitious assets such as expenditure carried forward in suspense, should be examined in order to ascertain whether they really represent value, the benefit of which will be obtained by the Company.

The procedure to be followed in investigating on behalf of a Shareholders' Committee of Inspection, will be determined by the instructions received from the Committee, and the nature of the trade and circumstances of the Company. Any transactions entered into by the Company with Directors personally, or with other parties or Companies with which they are connected, should receive careful scrutiny.

§ 4.—Investigations for Fraud.

It has been pointed out in Chapter I., § 3, that Fraud may be divided into two classes, viz. :—Defalca-

tions, involving misappropriations either of money or goods, or the manipulation of Accounts, not involving defalcations. The conduct of Investigations where Fraud is suspected or known to have taken place varies very much according to the circumstances of each case, and it is not possible to consider the matter here except in the most general manner.*

The fraudulent manipulation of Accounts without corresponding defalcations has already been considered from time to time in the course of this work, and usually takes the form of the inflation of assets, or the omission of liabilities, for the purpose of making the position of a business better than it really is, or enabling profits to be distributed that have not been earned.

Defalcations involving misappropriations of Stock vary so much according to the nature of the goods and the trade carried on that it is not practicable to discuss the subject further here; but defalcations involving misappropriations of cash present many features in common, and it may be convenient to indicate the general course of procedure where an Investigation of this nature is made, taking as an instance the case of a trading business where fraud has been carried out by some individual in charge of the books and cash, who has absconded.

Full enquiries should be made as to the authority exercised by the defaulting clerk and the nature of his duties, as this will give some indication of the opportunities he may have taken advantage of. Assuming he has been in general control of the books and has been able to do practically what he liked, the Accountant would have to make a complete Investigation from

* For a consideration of the methods adopted in some actual cases of Fraud the reader is referred to "Some notable Frauds in Accounts," by HENRY C. PRINCE, F.C.A.

a date arranged with the owners of the business, paying particular attention to the following points, among others.

The Cash Book should be cast and vouched in detail and Certificates obtained of the opening and closing Bank Balances. The Passbook should be checked completely with the Cash Book, particular attention being paid to the dates when the receipts are paid in, and to ascertaining that each day's receipts have been included.

Where moneys received from Debtors have been misappropriated it is common to find that, in order to prevent the Debtor's Account appearing overdue in the Sales Ledger, moneys received from subsequent debtors are placed to the credit of the debtor whose remittance was originally misappropriated, this process being continued indefinitely. In such cases it may become necessary for the cashier to divide certain cheques in order to obtain the exact amounts necessary for his purpose, and one method of discovering whether this has been done is to obtain, if possible, the original Paying-in Slips from the Bank, and compare them with the Counterfoils of the Paying-in Book. The slip presented to the Bank will contain the correct record of the amount of each cheque, whereas the Counterfoil will show any improper division that may have taken place. This also serves as a check upon the improper manipulation of discounts by the same methods. All discounts of any consequence appearing in the Cash Book should be tested, in order to ascertain that they are in order.

• Where Counterfoil Receipt Books have been utilised, the Counterfoils should be checked with the Cash Book ; and where Rough or Memoranda Cash Books or Cash

Diaries have been kept, these should be compared with the Fair Cash Book.

It should be seen that the proceeds of all Bills Receivable have been duly received, and Bills in hand should be examined.

As regards cash payments, special care should be taken, in examining the vouchers, to note any that appear to be irregular; and it is advisable that the returned cheques and endorsements thereon should be examined. In the case of any vouchers being missing, duplicates should be obtained. All amounts charged to the Drawing Accounts of Partners should be vouched by them as being correct.

The Petty Cash Book should be vouched and cast, as this is a very likely source of fraud. Special attention must be paid to salaries and wages, and the Accountant should ascertain that the names of all the employees, and the amounts received by them, are correct.

The best method of verifying the balances on the Sales Ledgers, where it is suspected that amounts have been misappropriated, is for the Accountant to send out a circular to the debtors, stating the amount of the balance as shown in the books, and asking for communication to be made to him in the event of the figure not being correct. In many cases, however, the proprietors of the business do not care for this to be done, and in any case their permission must be obtained in the first instance. Where such circularisation is not carried out it will be impossible for the Accountant to make sure that he has traced the whole of the misappropriations from this source, although these will declare themselves in due course, as statements are sent out.

Where the defaulting party has had access to all the books, it will be necessary for the whole of the post-

ings to be checked, and the books cast, and a Trial Balance obtained. In checking the Sales Ledgers, special attention should be paid to all allowances and bad debts written off, as entries of this nature may have been made for the purpose of concealing misappropriations of cash. Similar remarks apply to Returns, and where necessary the receipt of the actual goods returned should be traced. In some cases it may be found that the defaulting party has omitted to record sales in the Sales Day Books, in order that when remittances are received he can appropriate the same without having to falsify the books further. In order to ascertain whether this has been done, the Order Book should be tested with the Sales Day Books, to see that all orders that have been executed have been entered up, and, if necessary, reference should be made to the Goods Issued Book. Where Cash Sales are made these should be vouched in detail with whatever evidence may be available, although unless the system employed is a good one, it is a matter of great difficulty to ascertain whether irregularities have occurred.

Invoices should be vouched with the Bought Journal, in order to ascertain that none have been passed through twice, payment in respect of the original Invoice being made to the creditor but payment for the duplicate being misappropriated by the defaulting party. Duplicates should be obtained of missing Invoices, and the Creditors' Statements compared with the balances as shown by the Bought Ledger.

'If the Investigation is carried out on the lines above indicated, subject to variations according to the circumstances of each case, it should be possible to ascertain the extent of the misappropriations.'

SYNOPSIS OF APPENDIX OF STATUTES

§ 1 PARLIAMENTARY COMPANIES

- (a) The Companies Clauses (Consolidation) Act 1844
- (b) The Companies Clauses Act 1863
- (c) The Companies Clauses Act 1869

2 —RAILWAY COMPANIES

- (a) The Railway Companies Act 1867
- (b) The Regulation of Railways Act 1868
- (c) The Railway Companies (Accounts and Returns) Act 1911
- (d) Forms of Accounts prescribed by the Railway Companies (Accounts and Returns) Act 1911

3 —GAS COMPANIES

- (a) The Gas Works Clauses Act 1847
- (b) The Gas Works Clauses Act 1871
- (c) Form of Accounts prescribed by Gas Works Clauses Act, 1871

4 —WATER COMPANIES

- Water Works Clauses Act 1847

5 —ELECTRIC LIGHTING COMPANIES

- (a) The Electric Lighting Act 1882
- (b) Form of Accounts prescribed for Electric Lighting Companies
- (c) The Electric Lighting (Clauses) Act 1899.

6 —ASSURANCE COMPANIES

- (a) The Assurance Companies Act 1909.
- (b) Form of Accounts prescribed by the Assurance Companies Act, 1909

7 —BUILDING SOCIETIES

- (a) The Building Societies Act, 1874
- (b) The Building Societies Act, 1894
- (c) Form of Accounts prescribed under the Building Societies Acts, 1874 and 1894

8.—FRIENDLY SOCIETIES

- (a) The Friendly Societies Act, 1896.
- (b) Form of Return prescribed under the Friendly Societies Act, 1896.
- (c) The Friendly Societies Act, 1908

- (d) The Societies Borrowing Powers Act, 1898
- (e) The Collecting Societies and Industrial Assurance Companies Act 1896
- (f) Form of Annual Return required under the Collecting Societies and Industrial Assurance Companies Act 1896

9 —INDUSTRIAL AND PROVIDENT SOCIETIES

- (a) The Industrial and Provident Societies Act 1893
- (b) The Industrial and Provident Societies Amendment Act 1913
- (c) Form of Return prescribed under the Industrial and Provident Societies Act 1893

10 —CONDITIONS UNDER WHICH PUBLIC AUDITORS HOLD THEIR APPOINTMENTS AND SEAT OF OFFICE

11 —IRISH SAVINGS BANKS

- (a) The Trustee Savings Banks Act 1863
- (b) The Savings Banks Act 1891

12 —EXECUTORS AND TRUSTEES

- (a) The Public Trustee Act 1906
- (b) The Public Trustee Rules 1912
- (c) The Judicial Trustees Act 1896
- (d) The Judicial Trustees Rules 1897
- (e) The Apportionment Act 1870
- (f) The Intestates Estates Act 1890
- (g) The Trustee Act 1893
- (h) The Colonial Stock Act 1900

13 —MINES IN THE STANNARIES

- (a) The Stannaries Act 1869
- (f) The Stannaries Act 1887

14 —LICENSED PROFESSIONS

- (a) The Licensing Act 1904
- (b) The Licensing Rules 1901

15 —TERRITORIAL AND RESERVE FORCES ACT, 1907

16 —THE POKE OF LONDON ACT, 1903

17 —LOCAL AUTHORITIES

- (a) The Public Health Act, 1875
- (b) The District Auditors Act, 1879
- (c) The Municipal Corporations Act, 1882
- (d) The Local Government Act, 1888
- (e) The Local Government Act, 1894
- * (f) The London Government Act, 1899
- (g) The Metropolis Water Act, 1902 *

APPENDIX OF STATUTES.

§ 1.—Parliamentary Companies.

(a) The Companies Clauses Consolidation Act, 1845.

Application of Act.

1. This Act shall apply to every Joint Stock Company which shall by any Act which shall hereafter be passed be incorporated for the purpose of carrying on any undertaking, and this Act shall be incorporated with such Act; and all the clauses and provisions of this Act, save so far as they shall be expressly varied or excepted by any such Act, shall apply to the Company which shall be incorporated by such Act, and to the undertaking for carrying on which such Company shall be incorporated, so far as the same shall be applicable thereto respectively; and such clauses and provisions, as well as the clauses and provisions of every other Act which shall be incorporated with such Act, shall, save as aforesaid, form part of such Act, and be construed together therewith as forming one Act.

Register of Shareholders.

9. The Company shall keep a book to be called the "Register of Shareholders"; and in such book shall be fairly and distinctly entered, from time to time, the names of the several Corporations, and the names and addresses of the several persons entitled to shares in the Company, together with the number of shares to which such shareholders shall be respectively entitled, distinguishing each share by its number, and the amount of the subscriptions paid on such shares, and the surnames or corporate names of the said shareholders shall be placed in alphabetical order; and such book shall be authenticated by the common seal of the Company being affixed thereto; and such authentication shall take place at the first ordinary meeting, or at the next subsequent meeting of the Company, and so from time to time at each ordinary meeting of the Company.

Shareholders' Address Book.

10. In addition to the said Register of Shareholders, the Company shall provide a book, to be called the "Shareholders' Address Book," in which the Secretary shall from time to time enter in alphabetical order the corporate names and places of business of the several shareholders of the Company, being Corporations, and the surnames of the several other shareholders, with their respective Christian names, places of abode and descriptions, so far as the same shall be known to the Company; and every shareholder, or if such shareholder be a Corporation the clerk or agent of such Corporation, may at all convenient times peruse such book gratis, and may require a copy thereof or of any part thereof, and for every hundred words so required to be copied the Company may demand a sum not exceeding sixpence.

Register of Mortgages and Bonds.

45. A Register of Mortgages and Bonds shall be kept by the Secretary, and within fourteen days after the date of any such mortgage or bond an entry or memorial, specifying the number and date of such mortgage or bond and the sums secured thereby, and the names of the parties thereto, with their proper additions, shall be made in such Register; and such Register may be perused at all reasonable times by any of the shareholders, or by any mortgagee or bond creditor of the Company, or by any person interested in any such mortgage or bond, without fee or reward.

Register of Stock.

63. The Company shall from time to time cause the names of the several parties who may be interested in any such stock as aforesaid, with the amount of the interest therein possessed by them respectively, to be entered in a book to be kept for the purpose, and to be called "The Register of Holders of Consolidated Stock."

Application of Capital.

65. And be it enacted, that all the money raised by the Company, whether by subscriptions of the shareholders, or by loan or otherwise, shall be applied, firstly, in paying the costs and expenses incurred in obtaining the special Act, and all expenses incident thereto, and, secondly, carrying the purposes of the Company into execution.

Minute Books.

98. The Directors shall cause notes, minutes, or copies, as the case may require, of all appointments made or contracts entered into by the Directors, and of the orders and proceedings of all meetings of the Company and of the Directors and Committees of Directors, to be duly entered in books, to be from time to time provided for the purpose, which shall be kept under the superintendence of the Directors, and every such entry shall be signed by the Chairman of such meeting.

Auditors.

101. Except where, by the special Act, Auditors shall be directed to be appointed otherwise than by the Company, the Company shall, at the first ordinary meeting after the passing of the special Act, elect the prescribed number of Auditors, and if no number is prescribed two Auditors, in like manner as is provided for the election of Directors; and at the first ordinary meeting of the Company in each year thereafter the Company shall in like manner elect an Auditor to supply the place of the Auditor then retiring from office, according to the provision herein-after contained; and every Auditor elected as hereinbefore provided, being neither removed nor disqualified nor having resigned, shall continue to be an Auditor until another be elected in his stead.

102. Where no other qualification shall be prescribed by the special Act, every Auditor shall have at least one share in the undertaking; and he shall not hold any office in the Company, nor be in any other manner interested in its concerns, except as a shareholder.

103. One of such Auditors (to be determined in the first instance by ballot between themselves, unless they shall otherwise agree, and afterwards by seniority) shall go out of office at the first ordinary meeting in each year; but the Auditor so going out shall be immediately re-eligible, and after any such re-election shall, with respect to the going out of office by rotation, be deemed a new Auditor.

104. If any vacancy take place among the Auditors in the course of the current year, then at any general meeting of the Company the vacancy may, if the Company think fit, be supplied by election of the shareholders.

105. The provision of this Act respecting the failure of an ordinary meeting at which Directors ought to be chosen shall apply, *mutatis mutandis*, to any ordinary meeting at which an Auditor ought to be appointed.

106. The Directors shall deliver to such Auditors the half yearly or other periodical Accounts and Balance Sheet fourteen days at the least before the ensuing ordinary meeting at which the same are required to be produced to the shareholders as hereinafter provided.

107. It shall be the duty of such Auditors to receive from the Directors the half-yearly or other periodical Accounts and Balance Sheet required to be presented to the shareholders and to examine the same.

108. It shall be lawful for the Auditors to employ such Accountants and other persons as they may think proper, at the expense of the Company, and they shall either make a special report on the said Accounts, or simply confirm the same; and such report or confirmation shall be read, together with the report of the Directors, at the ordinary meeting.

Accounts.

115. The Directors shall cause full and true Accounts to be kept of all sums of money received or expended on account of the Company by the Directors and all persons employed by or under them, and of the matters and things for which such sums of money shall have been received or disbursed and paid.

116. The books of the Company shall be balanced at the prescribed periods, and, if no periods be prescribed, fourteen days at least before each ordinary meeting; and, forthwith on the books being so balanced, an exact Balance Sheet shall be made up, which shall exhibit a true Statement of the Capital Stock, Credits, and Property of every description belonging to the Company, and the debts due by the Company at the date of making such Balance Sheet, and a distinct view of the Profit or Loss which shall have arisen on the transactions of the Company in the course of the preceding half-year; and previously to each ordinary meeting such Balance Sheet shall be examined by the Directors, or any three of their number, and shall be signed by the Chairman or Deputy-Chairman of the Directors.

117. The books so balanced, together with such Balance Sheet as aforesaid, shall for the prescribed periods, and if no periods be prescribed

for fourteen days previous to each ordinary meeting, and for one month thereafter, be open for the inspection of the shareholders at the principal office or place of business of the Company but the shareholders shall not be entitled at any time, except during the periods aforesaid, to demand the inspection of such books, unless in virtue of a written order signed by three of the Directors

118 The Directors shall produce to the shareholders assembled at such ordinary meeting the said Balance Sheet applicable to the period immediately preceding such meeting, together with the report of the Auditors thereon, as hereinafter provided

119 The Directors shall appoint a book keeper to enter the Accounts aforesaid in books to be provided for the purpose, and every such book keeper shall permit any shareholder to inspect such books and to take copies or extracts therefrom at any reasonable time during the prescribed periods, and if no periods be prescribed, during one fortnight before, and one month after, every ordinary meeting

Dividends

120 Previously to every ordinary meeting at which a dividend is intended to be declared the Directors shall cause a scheme to be prepared, showing the profits, if any, of the Company for the period current since the preceding ordinary meeting at which a dividend was declared, and apportioning the same, or so much thereof as they may consider applicable to the purposes of dividend, among the shareholders, according to the shares held by them respectively, the amount paid thereon, and the periods during which the same may have been paid, and shall exhibit such scheme at such ordinary meeting, and at such meeting a dividend may be declared according to such scheme

121 The Company shall not make any dividend whereby* their Capital Stock will be in any degree reduced. Provided always that the word "Dividend" shall not be construed to apply to a return of any portion of the Capital Stock, with the consent of all the Mortgagees and Bond Creditors of the Company, due notice being given for that purpose at an extraordinary meeting to be convened for that object

122 Before apportioning the profits to be divided among the shareholders the Directors may, if they think fit, set aside thereout such sum as they may think proper to meet contingencies, or for enlarging, repairing, or improving the works connected with the Undertaking, or any part thereof, and may divide the balance only among the shareholders

123 No dividends shall be paid in respect of any share until all calls then due in respect of that and every other share held by the person to whom such dividend may be payable shall have been paid.

(b) The Companies Clauses Act, 1863.

Preference Dividends

14 The preference shares or preference stock shall be entitled to the preferential dividend, or interest assigned thereto, out of the profits

of each year, in priority to the ordinary shares and ordinary stock of the Company; but if in any year ending on the day prescribed in the special Act, and if no day is prescribed then on the thirty-first day of December, there are not profits available for the payment of the full amount of preferential dividend or interest for that year, no part of the deficiency shall be made good out of the profits of any subsequent year, or out of any other funds of the Company.

Register of Debenture Stock.

28. The Company shall cause entries of the debenture stock from time to time created to be made in a Register to be kept for that purpose, wherein they shall enter the names and addresses of the several persons and corporations from time to time entitled to the debenture stock, with the respective amounts of the stock to which they are respectively entitled.

Separate Accounts of Debenture Stock.

33. Separate and distinct Accounts shall be kept by the Company, showing how much money has been received for or on account of debenture stock, and how much money borrowed or owing on mortgage or bond, or which they have power so to borrow, has been paid off by debenture stock, or raised thereby, instead of being borrowed on mortgage or bond.

(c) The Companies Clauses Act, 1869.

Power to issue Shares on Stock at a Discount.

5. Section 21 of the Companies Clauses Act, 1863, shall, with respect to any Company to which it is applicable under the provisions of this or any other Act, be read and have effect as if the following words, that is to say, "but so that not less than the full nominal amount of any share or portion of stock be payable or paid in respect thereof," had not been inserted in that section.

6. Any shares forming part of the capital (whether original or additional) authorised to be raised by any special Act of a Company passed before the present session which have not been disposed of may be disposed of in manner provided by Part II. of the Companies Clauses Act, 1863, as amended by this Act, and that part, as so amended, shall be deemed incorporated with such special Act accordingly.

7. Provided that any shares, the creation whereof has been authorised by a Company, but which have not been issued before the passing of this Act, shall not be issued on any terms other than those whereon the same might have been issued if this Act had not been passed unless and until the issue thereof on terms other than as aforesaid is after the passing of this Act authorised by the Company in manner provided by Part II. of the Companies Clauses Act, 1863.

8. Provided always, that this Act shall not be construed to alter or extend the provisions of any Act relating to share capital in respect of which the amount of profits to be divided is limited to a fixed rate per centum upon the paid-up capital of the Company.

§ 2.—Railway Companies.

(a) The Railway Companies Act, 1867.

Power to issue Stock at a Discount.

27. Section 21 of the Companies Clauses Act, 1863, shall, with respect to any special Act of a Company incorporating Part II. [Sections 12 to 21] of that Act, whether passed or to be passed, be read and have effect as if the following words, that is to say, " but so that not less than the full nominal amount of any share or portion of stock be payable or paid in respect thereof," had not been inserted in that section.

Audit Certificate.

30. No dividend shall be declared by a Company until the Auditors have certified that the *half-yearly* Accounts proposed to be issued contain a full and true statement of the financial condition of the Company, and that the dividend proposed to be declared on any shares is *bonâ fide* due thereon after charging the revenue of the *half-year* with all expenses which ought to be paid thereout in the judgment of the Auditors; but if the Directors differ from the judgment of the Auditors with respect to the payment of any such expenses out of the revenue of the *half-year*, such difference shall, if the Directors desire it, be stated in the Report to the shareholders, and the Company in General Meeting may decide thereon, subject to all the provisions of the law then existing, and such decision shall for the purposes of the dividend be final and binding; but if no such difference is stated, or if no decision is given on any such difference, the judgment of the Auditors shall be final and binding; and the Auditors may examine the books of the Company at all reasonable times, and may call for such further Accounts, and such vouchers, papers, and information, as they think fit, and the Directors and Officers of the Company shall produce and give the same as far as they can, and the Auditors may refuse to certify as aforesaid until they have received the same; and the Auditors may at any time add to their Certificate, or issue to the shareholders, independently at the cost of the Company, any statement respecting the financial condition and prospects of the Company which they think material for the information of the shareholders.

Note.—This section must be read in conjunction with section 4 of the *Railway Companies (Accounts and Returns) Act, 1911.*

(b) The Regulation of Railways Act, 1868.

Auditors.

11. Whenever, after the passing of this Act, Section One hundred and two of the Companies Clauses* Consolidation Act, 1845, is incorporated in a Certificate or special Act relating to a Railway Company, it shall be construed as if the words, "where no qualification shall be prescribed by the special Act every Auditor shall have at least one share in the undertaking," were omitted therefrom; and so much of every Certificate and special Act relating to a Railway Company, and in force at the passing of this Act, as incorporates that portion of the said section, and so much of any special Act relating to a Railway Company, and so in force as contains a like provision, is hereby repealed.

12. With respect to the Auditors of the Company, the following provisions shall have effect :

- (1) The Board of Trade may, upon application made in pursuance of a resolution passed at a meeting of the Directors or at a general meeting of the Company, appoint an Auditor in addition to the Auditors of such Company, and it shall not be necessary for any such Auditor to be a shareholder in the Company ;
- (2) The Company shall pay to such Auditor appointed by the Board of Trade such reasonable remuneration as the Board of Trade may prescribe ;
- (3) The Auditor so appointed shall have the same duties and powers as the Auditors of the Company, and shall report to the Company ;
- (4) Where, in consequence of such appointment of an Auditor or otherwise, there are three or more Auditors, the Company may declare a dividend if the majority of such Auditors certify in manner required by Section thirty of the Railway Companies Act, 1867, and the Railway Companies (*Scotland*) Act, 1867 respectively ;
- (5) Where there is a difference of opinion among such Auditors, the Auditor who so differs shall issue to the shareholders, at the cost of the Company, such statement respecting the grounds on which he differs from his colleagues, and respecting the financial condition and prospects of the Company, as he thinks material for the information of the shareholders.

Issue of Preferred and Deferred Ordinary Stock

13. Any Company which, in the year immediately preceding, has paid a dividend on their Ordinary Stock of not less than three pounds *per centum per annum* may, pursuant to the resolution of an extraordinary general meeting, divide their paid-up Ordinary Stock into two classes, to be and to be called the one Preferred Ordinary Stock, and the other Deferred Ordinary Stock, and issue the same subject and according to the following provisions, and with the following consequences (that is to say) :

- (1) Preferred and Deferred Ordinary Stock shall be issued only in substitution for equal amounts of paid-up Ordinary Stock, and by way of division of portions of Ordinary Stock, into two equal parts ;
- (2) As between Preferred Ordinary Stock and Deferred Ordinary Stock, Preferred Ordinary Stock shall bear a fixed maximum dividend at the rate of six *per centum per annum* ;
- (3) In respect of dividend to the extent of the maximum aforesaid, Preferred Ordinary Stock shall at the time of its creation, and at all times afterwards, have priority over Deferred Ordinary Stock created or to be created, and shall rank *pari passu* with the undivided Ordinary Stock and the Ordinary Shares of the Company created or to be created ; and in respect of dividend, Preferred Ordinary Stock shall at all times and to all intents rank after all Preference and Guaranteed Stock and Shares of the Company created or to be created :

- (8) In each year after all holders of Preferred Ordinary Stock for the time being issued have received in full the maximum dividend aforesaid, all holders of Deferred Ordinary Stock for the time being issued shall, in respect of all dividend exceeding that maximum paid by the Company in that year on Ordinary Stock and Shares, rank *pari passu* with the holders of undivided Ordinary Stock and of Ordinary Shares of the Company for the time being issued ;
- (9) If, nevertheless, in any year ending on the thirty-first day of December, there are not profits available for payment to all the holders of Preferred Ordinary Stock of the maximum dividend aforesaid, no part of the deficiency shall be made good out of the profits of any subsequent year, or out of any other funds of the Company.

(c) The Railway Companies (Accounts and Returns) Act, 1911.

1.--(1) Every railway company shall annually prepare accounts and returns in accordance with the form set out in the First Schedule to this Act, and shall submit their accounts to their auditors in that form.

(2) The accounts and returns shall be signed by the officer of the company responsible for the correctness of the accounts or returns, or any part thereof, and, in the case of an incorporated railway company, by the chairman or deputy chairman of the directors of the company, and shall be made up for the year ending the thirty-first day of December, or such other day as the Board of Trade may fix in the case of any company or class of companies to meet the special circumstances of that company or class of companies.

(3) Every railway company shall forward six copies of the accounts and returns to the Board of Trade not later than sixty days after the expiration of the year for which the accounts and returns are made up, and, in the case of an incorporated railway company, shall forward a copy of the accounts and returns to any shareholder or debenture holder of the Company who applies for a copy.

(4) If any railway company fails to prepare or forward in accordance with this section, such accounts and returns as are thereby required, the company shall be liable on summary conviction to a fine not exceeding five pounds for every day during which the default continues.

(5) If any account or return prepared and forwarded under this section is false in any particular to the knowledge of any person who signs the account or return or any part thereof, that person shall be liable on conviction on indictment to imprisonment with or without hard labour for a term not exceeding one year, or to a fine not exceeding one hundred pounds, and on summary conviction to a fine not exceeding fifty pounds.

4.--(1) A railway company shall not be under any obligation to prepare or to submit to their shareholders or auditors, statements of accounts or balance sheets, or to hold ordinary general meetings more than once a year, and anything which under any special Act is authorized or required to be done at a general meeting of a railway company to be held at any specified time may be done at the annual general meeting of the company at whatever time held :

Provided that nothing in this provision shall relieve a railway company of any obligation to prepare half-yearly accounts in cases where those accounts are required in connection with any guarantee of dividend under any such statutory provisions:

(2) The directors of an incorporated railway company may, if it appears to them that the profits of the company are sufficient, declare and pay an interim dividend for the first half of any year, notwithstanding that the accounts are not audited for the half-year, and that a statement of accounts and balance sheet for the half-year is not submitted to the shareholders, and may close their register and books of transfer before the date on which the interim dividend is declared in the same manner and for the same time and subject to the same provisions as they may close their register or books before the date on which their ordinary dividend is declared or before the date of their ordinary meeting.

(3) Any statutory provisions affecting the railway company shall be read with the modifications necessary to bring them into conformity with this section.

(c) Forms of Account prescribed by the Railway Companies (Accounts and Returns) Act, 1911.

FORM OF ACCOUNTS AND STATISTICAL RETURNS.

PART I.

FINANCIAL ACCOUNTS.

(Nos. 1 to 7, Capital Accounts.)

[No. 1 (a).] NOMINAL CAPITAL AUTHORISED, AND CREATED BY THE COMPANY.

Special Acts.	Capital authorised.			Capital created.			Balance.		
	Shares and Stock.	Loans or Debenture Stock.	Total.	Shares and Stock.	Loans or Debenture Stock.	Total.	Shares and Stock.	Loans or Debenture Stock.	Total.
I. Special Acts conferring capital powers which have been fully exercised .. Totals ..									
II. Special Acts conferring capital powers which have not yet been fully exercised ..									
[Each such Act to be stated here separately in order of date.]									
1.									
2.									
etc.									
Total ..									

NOTE.—Where a Special Act has been consolidated in a later Act, a reference to the Consolidating Act is sufficient.

[No 1 (b)] NOMINAL CAPITAL AUTHORISED, AND CREATED
BY THE COMPANY JOINTLY WITH SOME OTHER COMPANY.

Special Acts	Capital authorised	Capital created	Balance
	Shares and Stock	Shares and Stock	Shares and Stock
	Loans or Debenture Stock	Loans or Debenture Stock	Loans or Debenture Stock
	Total	Total	Total

[No 1 (c)] NOMINAL CAPITAL AUTHORISED, AND CREATED
BY SOME OTHER COMPANY ON WHICH THE COMPANY EITHER JOINTLY
OR SEPARATELY GUARANTEES FIXED DIVIDENDS

[illegible]

0] ;

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[No 2] . SHARE CAPITAL AND STOCK CREATED, AS PER STATEMENT No. 1 (a), SHOWING THE PROPORTION ISSUED.

Description	Amount created	Amount issued	Amount added to or deducted from Capital	Amount, which Dividend is payable	Amount which does not rank for Dividend until a future date	Calls in arrear	Amount uncalled	Amount unissued
[Each class of shares and stock to be stated in order of date of creation with the preferential or fixed dividends, if any to which it is entitled and any other conditions attached to it]	£	£	£	£	£	£	£	£
Total								

NOTE — A column to be provided when necessary between Amount Created and Amount Issued to show Additional Stock Issued to provide Authorised Money.

[No 3] CAPITAL RAISED BY LOANS AND DEBENTURE STOCK

	Raising by Loans					Raising by Issue of Debenture Stocks					Total raised by Loans or Debenture Stocks	
	At				Total Loans	Amount added to or deducted from Capital	Existing Amount of Stock			Total Debenture Stock		
	per cent	per cent	per cent	per cent			per cent	per cent	per cent			
Existing at	£	£	£	£	£	£	£	£	£	£	£	
Existing at												
Increase												
Decrease												

Total Amount authorised to be raised by Loans and Debenture Stocks in respect of Capital created, as per Statement No. 1 (a)

Less—Amount created but not yet available

Reduction of Borrowing Power in respect of Interest paid out of Capital

Capitalised Value of Rent Charges, Annuities, or Land Duties, in accordance with section 5 of the Lands Clauses Consolidation Acts Amendment Act, 1860

Other deductions, if any

Total deductions

Total Amount raised by Loans and Debenture Stock as above

Balance being available Borrowing Powers at

c] :

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[No 4 (a)] SUBSCRIPTIONS TO OTHER COMPANIES.

Name	Amount	Nature of Security or Investment
(a) Railway Companies		--
(b) Other		--

[No 5] DETAILS OF CAPITAL EXPENDITURE FOR YEAR ENDING

	Fund and Contribution		Construction of Way and Stations and Plant and Machinery &c		Law Charges and Pat- entary Expenses		Total		
	£	s	d	£	s	d	£	s	d
Purchase of Railways (particulars)									
Lines belonging to the Company open for Traffic (particulars)									
Lines belonging to the Company not open for Traffic —									
New Lines (particulars)									
Widening of and Additions to existing Lines (particulars)									
Lines Leased (particulars)									
Lines Jointly Owned (particulars)									
Lines Jointly Leased (particulars)									
Rolling Stock									
Locomotives				(Number and type of each)					
Conching Vehicles				(Description of the horse in)					
Wagons				(according with Rolling)					
Service Vehicles				(Stock & (lines))					
Manufacturing and Repairing Works and Plant (particulars)									
Horses									
Road Vehicles employed in the Collection and Delivery of Parcels, Goods and Passengers (particulars)									
Steamboats (particulars)									
Canals (particulars)									
Docks, Harbours, and Wharves (particulars)									
Hotels (particulars)									
Electric Power Stations &c (particulars)									
Land, Property &c, not forming part of the Railway or Stations									
(a) Used in connection with Railway Working (particulars)									
(b) Not used in connection with Railway Working (particulars)									
Subscriptions to other Companies (particulars)									
(a) Railway Companies									
(b) Other									
Special Items (details to be given)									

Total Capital Expenditure for the Year

[No 6] ESTIMATE OF FURTHER EXPENDITURE ON CAPITAL ACCOUNT

Expendi- ture to date on Principal Works in progress	Estimated further Expenditure			
	During the Year ending	Subse- quently until com- pletion	Total	
	£	£	£	
Purchase of Railways (particulars)				
Lines belonging to the Company				
open for Traffic (particulars)				
Lines belonging to the Company				
not open for Traffic				
New Lines (particulars)				
Widening of and Additions to				
existing Lines (particulars)				
Lines Leased (particulars)				
Lines Jointly Owned (particulars)				
Lines Jointly Leased (particulars)				
Rolling Stock				
Manufacturing and Repairing Works				
and Plant				
Steamboats				
Canals				
Docks, Harbours and Wharves				
Hotels				
Electric Power Stations &c				
Subscriptions to other Companies				
Special Items				
Miscellaneous				
	Total			
	Works not yet commenced and in progress			

[No 7] CAPITAL POWERS AND OTHER ASSETS AVAILABLE TO
MEET FURTHER EXPENDITURE ON CAPITAL ACCOUNT

Stock, share and Loan Capital authorized but not yet created (as per Statement No 1 (a))	£	£
Stock and share Capital created but not yet received (as per Statement No 2) —		
Calls in arrear		
Amount uncalled		
Amount unissued		
Loan Capital created but not yet available (as per Statement No 3)		
Available Borrowing Powers (as per Statement No 3)		
Add or Deduct	balance at	(Credit or Debit)
(as per Capital Account No. 4)		
Total		

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(Nos 8 to 18, Revenue Accounts)

NO 8 —REVENUE RECEIPTS AND EXPENDITURE OF THE WHOLE
UNDERTAKING

No	State ment				Year 19		
		Gross	Expendi	Net	Gross Receipts	Expendi ture	Net Receipts
		Receipts	ture	Receipts			
		£	s	d	£	s	d
10	Railway						
11	Omnibuses and other Pas senger Vehicles not run ning on the Railways						
12	Steamboats						
13	Canals						
14	Docks, Harbours and Wharves						
15	Hotels and Refreshment Rooms and Canteens where catering is carried on by the Company						
16	Other separate businesses carried on by the Com pany (in detail)						
	Total	£					
Miscellaneous Receipts (Net)							
	Rents from houses and lands						
	Rents from hotels						
	Other Rents, including lump sum tolls						
	Interest and Dividends from Investments in other Companies (in detail)						
	Transfer Fees						
	General Interest						
	Special Items						
Total Net Income							

[No. 9.] PROPOSED APPROPRIATION OF NET INCOME

		Year 19
	£ s d	£
Balance brought forward from last year's Account		
Net Income (as per Statement No. 8)		
Appropriation to Reserve		
Total	£ s d	
<i>Deduct</i> interest, rental, and other fixed charges (to be stated by each Company in order of priority)		
Interest on Superannuation and other Funds		
Leasehold charges (or feu duties) and Annuities		
Chief rents, wayleaves, &c. including lump sum tolls		
Interest on Loans		
Interest on Debenture Stocks (defaul)		
Rent of and guaranteed Interest on Leased and Worked Mines		
Interest on Flooded Bonds		
General Interest		
Special Items (if any)		
Total	£	
Balance after Payment of Fixed Charges		
Appropriation to Reserve and other special purposes (Defaul)	£ s d	
Total	£	
Dividends on Guaranteed and Preference Stocks (Defaul)	£ s d	
Total	£	
Balance available for Dividends on Ordinary Stock (Defaul)	£ s d	
Total	£	

[No. 9 (a).] STATEMENT OF INTERIM DIVIDENDS PAID

	£ s d	£
Balance available for Dividends, Year 19		
<i>Deduct</i> —		
Interim Dividends paid (particulars)	£ s d	
Undivided Balance at 31st December, carried to Balance Sheet	

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Dr. No 10—RECEIPTS AND EXPENDITURE IN RESPECT OF RAILWAY WORKING Cr.

Expenditure	Percentage of Traffic Receipts		Receipts	Percentage of Traffic Receipts	
	£ s d	Per cent	£ s d	Per cent	Per cent
See Abstracts					
A Maintenance and renewal of Way and Works			Less from Traffic Ordinary Losses		
B Maintenance and renewal of Rolling stock			Trucks		
(1) Locomotives			Trucks		
(2) Carriages			Trucks		
(3) Wagons			Trucks		
C Locomotive Running Expenses			Trucks		
D Traffic Expenses			Trucks		
E General Charges			Trucks		
Low Charges			Trucks		
Parliamentary Expenses			Trucks		
Compensation (accidents and losses)			Trucks		
Passengers			Trucks		
Workmen			Trucks		
Damage and loss of Goods Property &c			Trucks		
Rates			Trucks		
Taxes			Trucks		
Government Duty			Trucks		
G Running Powers (Balance Debit or credit)			Trucks		
Total Traffic Expenditure			Trucks		
J Joint Lines*			Trucks		
Miscellaneous			Trucks		
Total Expenditure			Trucks		
Not Receipts			Trucks		
Total			Total		

NOTE—Gross receipts to include the whole of the receipts from traffic carried over the company's lines, except where (a) the traffic is carried over the company's line by means of other companies and no annual payment is made therefor, or where (b) the payment made is by way of a fixed rent. The proportion of traffic receipts accruing to other companies in respect of running powers exercised by them over the company's lines not to be treated as a deduction from the company's traffic receipts in this statement, but to be entered as a payment in the Running Powers Account (Abstract G). The proportion of the traffic receipts accruing to the company in respect of trains run by the company over the lines of other companies to be excluded from the traffic receipts in this statement, and entered as receipts in the Running Powers Account.

* Under this heading should be entered only the Expenditure or Receipts of jointly owned and jointly leased lines in respect of which the Accounts are prepared by or for the joint committee and are not already embodied in those of the parent companies (see Abstract J). In the case of other joint lines, the company's proportion of the Revenue and Expenditure to be spread over the various heads on the respective sides of this Account.

ABSTRACT A.—MAINTENANCE AND RENEWAL OF WAY AND WORKS.

	Year 19		
	£	s. d.	£
Superintendence :—			
Salaries			
Office Expenses			
Maintenance of Roads, Bridges and Works :—			
Earthworks			
Bridges, Tunnels, Culverts, Retaining Walls, and other Works			
Roads and Fences			
Maintenance of Permanent Way :—			
Renewal of Running Lines :—			
Wages			
Materials			
Engine Power and Wagon Repairs			
Repair of Running Lines and Sidings :—			
Wages			
Materials			
Engine Power and Wagon Repairs			
Maintenance of Signalling			
Maintenance of Telegraphs			
Maintenance of Stations and Buildings :—			
Stations, Depôts and Offices			
Engine Sheds			
Carriage Sheds			
Locomotive Workshops			
Carriage Workshops			
Wagon Workshops			
Other Buildings			
Total	£		

ABSTRACT B.—MAINTENANCE AND RENEWAL OF ROLLING STOCK.

(1) LOCOMOTIVES.

	Year 19		
	£	s. d.	£
Superintendence :—			
Salaries			
Office Expenses			
Complete Renewals :—			
Wages			
Materials			
Repairs and Partial Renewals :—			
Wages			
Materials			
Purchase of New Locomotives			
Workshop Expenses :—			
Repair and Renewals of Machinery and Plant			
Other Expenses			
Total	£		

NOTE.—When any sum is transferred to or from a Depreciation Fund or Suspense Account, the net sum to be stated.

c.] :

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(2) CARRIAGES.

			Year 19 .
	£ s. d.	£ s. d.	£
Superintendence :—			
Salaries			
Office Expenses			
Complete Renewals :—			
Wages			
Materials			
Repairs and Partial Renewals :—			
Wages			
Materials			
Purchase of New Carriages			
Workshop Expenses :—			
Repairs and Renewals of Machinery and Plant			
Other Expenses			
Total	£		

(3) WAGONS.

			Year 19 .
	£ s. d.	£ s. d.	£
Superintendence :—			
Salaries			
Office Expenses			
Complete Renewals :—			
Wages			
Materials			
Repairs and Partial Renewals :—			
Wages			
Materials			
Purchase of New Wagons			
Workshop Expenses :—			
Repairs and Renewals of Machinery and Plant			
Other Expenses			
Total	£		

NOTE.—When any sum is transferred to or from a Depreciation Fund or Suspense Account, the net sum to be stated.

ABSTRACT C.—LOCOMOTIVE RUNNING EXPENSES.

	Year 19	
	£ s. d.	£ s. d.
Superintendence :—		
Salaries		
Office Expenses		
Steam Train Working :—		
Wages connected with the Running of Locomotive Engines		
Fuel		
Water		
Lubricants		
Other Stores, including Clothing		
Miscellaneous		
Electric Train Working :—		
Wages of Motormen		
Electric Current		
Lubricants		
Other Stores, including Clothing		
Total	£	

NOTE.—Any other form of power to be shown separately with corresponding details.

ABSTRACT D.—TRAFFIC EXPENSES.

	Year 19	
	£ s. d.	£ s. d.
Salaries and Wages :—		
Superintendence		
Station Masters and Clerks		
Signalmen and Gatemen		
Ticket Collectors, Policemen, Porters, &c.		
Guards		
Fuel, Lighting, Water and General Stores		
Clothing		
Printing, Advertising, Stationery, Stamps and Tickets		
Wagon Covers, &c.		
Expenses of Joint Stations and Junctions		
Cleansing, Lubricating and Lighting of Vehicles		
Shunting Expenses (other than Mechanical)		
Working of Stationary Engines, Hoists, Cranes, &c.		
Coal, &c., tipping Expenses		
Railway Clearing House Expenses		
Miscellaneous Expenses		
Total	£	

RAILWAYS (ACCOUNTS AND RETURNS) ACT, 1911. 597

ABSTRACT E.—GENERAL CHARGES.

				Year 19
	£	s.	d.	£
Directors' Fees voted by Shareholders				
Fees paid to and Expenses of Directors on Joint Committees not included in Abstract J.				
Auditors and Public Accountants (Fees, Clerkage and Expenses)				
Salaries of Secretary, General Manager, Accountant and Clerks				
Office Expenses, ditto				
Rating Expenses				
Fire Insurance				
Superannuation and Benevolent Funds, Pensions, &c.				
*Subscriptions and Donations				
Miscellaneous Expenses				
Total	£			

* Amounts contributed to Institutions not directly controlled by the Company, and not for the exclusive benefit of the Company's servants.

ABSTRACT F.—EXPENSES OF COLLECTION AND DELIVERY OF PARCELS AND GOODS.

				Year 19
	£	s.	d.	£
Salaries and Wages				
Rent, Rates and Taxes				
Maintenance of Horses				
Maintenance of Horse Vehicles				
Maintenance of Motors				
Amounts paid for Hired Cartage				
Miscellaneous				
Total	£			
Amount Charged to Passenger Train Traffic	£			
Amount Charged to Goods Traffic	£			

NOTE.—The division of expenditure to be based as far as possible on actual figures.

ABSTRACT G.—RUNNING POWERS.

RECEIPTS AND PAYMENTS IN RESPECT OF RUNNING POWER EXPENSES.

	Re- ceipts.*	Pay- ments.†	Balance.	Year 19		
				Re- ceipts.*	Pay- ments.†	Balance.*
	£	£	£	£	£	£
Passenger Train Traffic						
Goods Train Traffic						
Total	£					

* Receipts are the sums received by a Company in respect of trains run by it over the lines of other Companies.

† Payments are the sums paid by a Company in respect of trains run by other Companies over its lines.

ABSTRACT H.—MILEAGE, DEMURRAGE, AND WAGON HIRE.

	Receipts.	Expenditure.	Balance.	Year 19		
				Receipts.	Expenditure.	Balance.
	£ s. d.	£ s. d.	£ s. d.	£	£	£
Mileage and Demurrage :—						
Passenger Train Vehicles						
Goods Train Vehicles						
Hire of :—						
Passenger Train Vehicles						
Goods Train Vehicles						
Total	£					

ABSTRACT J.—JOINTLY OWNED AND JOINTLY LEASED LINES.
RECEIPTS AND EXPENDITURE.

	Name of Joint Line.		Name of Joint Line.		Name of Joint Line.		Total.		Year 19
	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	Total.
Gross Receipts :—									£
(Details to follow Statement No. 10)									
Total Receipts									
Total Receipts, Company's Proportion									
Expenditure :—									
(Details to follow Statement No. 10)									
Total Expenditure									
Total Expenditure, Company's Proportion									

NOTE. —In this Abstract should be entered only the Receipts and Expenditure of jointly owned and jointly leased Lines in respect of which the Accounts are prepared by or for the Joint Committee, and are not embodied under their respective headings in the Accounts of the parent Companies.

[No 11.] RECEIPTS AND EXPENDITURE IN RESPECT OF OMNIBUSES
AND OTHER PASSENGER VEHICLES NOT RUNNING ON THE RAILWAY.

Dr.

Cr.

To Expenditure.	—	Year 19	By Gross Receipts.	—	Year 19
	£ s. d.	£		£ s. d.	£
Maintenance of Horses			Passengers		
Maintenance of Horse Vehicles			Hire of Vehicles		
Maintenance of Motors			Miscellaneous		
Maintenance of Buildings					
Traffic Expenses					
Miscellaneous					
Total Expenditure					
Balance					
Total	£		Total	£	

NOTE. —When any sum is transferred to or from a Depreciation Fund or Suspense Account, the net sum to be stated.

c.] :

RAILWAYS (ACCOUNTS AND RETURNS) ACT, 1911. 599

[No. 12.] RECEIPTS AND EXPENDITURE IN RESPECT OF STEAMBOATS.

Dr.

Cr.

To Expenditure.	—	Year 19	By Gross Receipts.	—	Year 19
	£ s. d.	£		£ s. d.	£
Salaries and Wages ..			Passengers		
Fuel			Parcels		
Stores, Lubricants, Water, &c. ..			Mails		
Repairs			Merchandise		
Harbour Fees and Light Dues ..			Live Stock		
Miscellaneous			Miscellaneous		
Working Expenses ..					
Depreciation and Insurance ..					
Total Expenditure ..					
Balance					
Total	£		Total	£	

[No. 13.] Dr. RECEIPTS AND EXPENDITURE IN RESPECT OF CANALS Cr.

To Expenditure.	—	Year 19	By Gross Receipts.	—	Year 19
	£ s. d.	£		£ s. d.	£
Superintendence ..			Tolls		
Wages of toll clerks, lock-keepers, &c. ..			Freight as Carriers ..		
Maintenance of Canal ..			Canal Dock Dues ..		
Water Supply			Wharfage and Cranage ..		
Auxiliary Tramway Expenses ..			Rents (Net Receipts) ..		
Traffic Expenses as Carriers ..			Miscellaneous		
Rates					
Taxes					
Miscellaneous					
Total Expenditure ..					
Balance					
Total	£		Total	£	

[No. 14.] RECEIPTS AND EXPENDITURE IN RESPECT OF DOCKS,

Dr.

HARBOURS, AND WHARVES.

Cr.

To Expenditure.	—	Year 19	By Gross Receipts.	—	Year 19
	£ s. d.	£		£ s. d.	£
Superintendence ..			Harbour Dues		
Maintenance			Light Dues		
Dredging			Dock Dues —		
Wages not included in above ..			On Ships		
Rates			On Goods		
Taxes			On Passengers		
Miscellaneous			Wharf and Pier Dues ..		
Total Expenditure ..			Cranage and other Services ..		
Balance			Graving Docks		
			Rents		
			Miscellaneous		
Total	£		Total	£	

NOTE.—When any sum is transferred to or from a Depreciation Fund or Suspense Account, the net sum to be stated.

[No. 15.] RECEIPTS AND EXPENDITURE IN RESPECT OF HOTELS,
AND OF REFRESHMENT ROOMS AND CARS WHERE CATERING IS CARRIED
Dr. ON BY THE COMPANY. Cr.

To Expenditure.	—	Year 19 .	By Gross Receipts.	—	Year 19 .
	£ s. d.	£		£ s. d.	£
Salaries and Wages			* Total Receipts from hotels and from sale of pro- visions, &c., in refresh- ment rooms and cars ..		
Provisions, wines and spirits consumed					
* Repairs and Maintenance of hotels and refreshment rooms, and of fittings, furniture, &c., of refresh- ment cars					
Heating and Lighting of hotels and refreshment rooms					
Rents					
Rates in respect of hotels ..					
Taxes in respect of hotels ..					
Miscellaneous.. ..					
Total Expenditure ..					
Balance					
Total			Total		

NOTE.—When any sum is transferred to or from a Depreciation Fund or Suspense Account, the net sum to be stated.

* To include in the case of hotels and refreshment rooms Expenditure on buildings, furniture and plant.

[No. 16.] RECEIPTS AND EXPENDITURE IN RESPECT OF OTHER
SEPARATE BUSINESSES CARRIED ON BY THE COMPANY.

RAILWAYS (ACCOUNTS AND RETURNS) ACT, 1911. 601

[No. 17.]

ELECTRIC POWER AND LIGHT ACCOUNT.

	Year 19				Year 19				
	£	s.	d.		Number of Units.	£	s.	d.	Number of Units.
Superintendence :—									
Salaries ..									
Office Expenses ..									
Total Superintendence				Current supplied					
				For Traction					
Generation :—				„ Power ..					
Maintenance of buildings ..				„ Lighting					
Maintenance of plant, machinery and tools ..				To other Consumers ..					
Maintenance of feeders, cables and accessories ..									
Salaries and Wages ..									
Fuel, including carriage, &c. ..									
Oil, waste, water and stores ..									
Special Items ..									
Total Generation ..									
Distribution :—									
Maintenance of feeders, mains and apparatus ..									
Maintenance of motors, switches, fuses, lamps, &c. .									
Salaries and Wages									
Royalties, &c., payable for use of patents ..									
Rents payable. .									
Rates ..									
Taxes ..									
Special Charges :—									
(To be enumerated)									
Total ..	£			Total ..					

NOTE.—When any sum is transferred to or from a Depreciation Fund or Suspense Account, the net sum to be stated.

[No 18] Dr

GENERAL BALANCE SHEET

Cr

	Year 19		Year 19
£ s d	£	£ s d	£
To Capital Account Balance at Credit thereof as per Account No 4		By Capital Account Balance at Debit thereof as per Account No 4	
Amount due to Bankers		Cash at Bankers and in hand	
Temporary Loans and Call paid in advance		Cash on Deposit at Interest	
Lloyd's Bonds		Investments in Consols and Government Securities	
Unpaid Interest and Dividends		Investments in Stocks and Shares held by the Company not charged as Capital Expenditure	
Interest and Dividend payable or accruing and provided for		Investment of Superannuation and other Provident Funds	
Amount due to Railway Companies and Committees		Stock of Stores and Materials	
Amount due to Railway Clearing Houses		Outstanding Traffic Accounts	
Savings Bank		Amount due by Railway Companies and Committees	
Superannuation and other Provident Funds		Amount due by Railway Clearing Houses	
Accounts Payable		Amount due by Postmaster General	
Liabilities Accrued		Accounts Receivable	
Miscellaneous Accounts		Miscellaneous Accounts	
Special Items (to be detailed)		Suspense Accounts (if any) to be enumerated	
The Insurance Fund		Special Items (to be detailed)	
Depreciation Funds			
Railway			
Steamboats (including Insurance Fund)			
Other Businesses			
General Reserve Fund			
£ s d			
Balance available for Dividends and Reserve as per Account No 9			
Less Interim Dividends paid, as per Statement No 9 (a)			

PART II.

STATISTICAL RETURNS.

CERTIFICATES OF THE RESPONSIBLE OFFICERS AS TO THE UPKEEP OF THE
WHOLE OF THE COMPANIES' PROPERTY.

(Signed for the Board
of Directors)

Chairman or Deputy Chairman of the Company.

Secretary of the Company.

AUDITOR'S CERTIFICATE.

*As prescribed by Acts 30 & 31 Victoria, Cap. 127, to follow, substituting
Yearly for Half-Yearly Accounts.*

§ 3.—Gas Companies.

(a) The Gas Works Clauses Act, 1847.

Profits to be Limited.

30. The profits of the Undertaking to be divided amongst the Undertakers in any year shall not exceed the prescribed rate, or where no rate is prescribed they shall not exceed the rate of ten pounds in the hundred by the year on the paid-up capital in the Undertaking, which in such case shall be deemed the prescribed rate, unless a larger dividend be at any time necessary to make up the deficiency of any previous dividend which shall have fallen short of the said yearly rate.

Reserved Fund.

31. If the clear profits of the Undertaking in any year amount to a larger sum than is sufficient, after making up the deficiency in the dividends of any previous year as aforesaid, to make a dividend at the prescribed rate, the excess beyond the sum necessary for such purpose shall from time to time be invested in Government or other securities; and the dividends and interest arising from such securities shall also be invested in the same or like securities, in order that the same may accumulate at compound interest until the fund so formed amounts to the prescribed sum, or if no sum be prescribed, a sum equal to one-tenth of the nominal capital of the Undertakers, which sum shall form a reserved fund to answer any deficiency which may at any time happen in the amount of divisible profits, or to meet any extraordinary claim or demand which may at any time arise against the Undertakers; and if such fund be at any time reduced, it may thereafter be again restored to the said sum, and so from time to time as often as such reduction shall happen.

32. Provided always, that no sum of money shall be taken from the said fund for the purpose of meeting any extraordinary claim, unless

it be first certified in *England* or *Ireland* by two Justices, and in *Scotland* by the Sheriff, that the sum so proposed to be taken is required for the purpose of meeting an extraordinary claim within the meaning of this or the special Act.

33. When such fund shall, by accumulation or otherwise, amount to the prescribed sum, or one-tenth of the nominal capital of the Company, as the case may be, the interest and dividends thereon shall no longer be invested, but shall be applied to any of the general purposes of the Undertaking to which the profits thereof are applicable.

34. If in any year the profits of the Undertaking divisible amongst the Undertakers shall not amount to the prescribed rate, such a sum may be taken from the reserved fund as, with the actual divisible profits of such year, will enable the Undertakers to make a dividend of the amount aforesaid, and so from time to time as often as the occasion shall require.

Appointment of Inspectors.

35. In *England* or *Ireland* the Court of Quarter Session, and in *Scotland* the Sheriff, may, on the petition of any two gas ratepayers, within the limits of the special Acts, nominate and appoint some accountant or other competent person, not being a proprietor of any gasworks to examine and ascertain at the expense of the Undertakers (the amount of such expense to be determined by the said Court or Sheriff) the actual state and condition of the concerns of the Undertakers, and to make report thereof to the said Court at the then present or some following sessions, or to the Sheriff; and the said Court or Sheriff may examine any witnesses upon oath touching the truth of the said accounts, and matters therein referred to; and if it thereupon appear to the said Court or Sheriff that the profits of the Undertakers for the preceding year have exceeded the prescribed rate, the Undertakers shall, in case the whole of the said reserved fund has been, and then remains, invested as aforesaid, and in case dividend to the amount hereinbefore limited had been paid, make such a rateable deduction in the rate of gas to be furnished by them as in the judgment of the said Court or Sheriff shall be proper, but at such rates as, when reduced, shall ensure to the Undertakers (regard being had to the amount of profit before received) a profit as near as may be to the prescribed rate.

37. If the Undertakers shall, for seven days after being required to produce to the said Court or Sheriff, or to the said accountant or other person as aforesaid, any books of account or other books, bills, receipts, vouchers, or papers, relating to the pecuniary affairs of the Undertakers, refuse or neglect to produce such books, bills, receipts, vouchers, or papers, they shall forfeit the sum of one hundred pounds for every such refusal or wilful neglect, and the further sum of ten pounds for every day such refusal or wilful neglect shall continue after the expiration of the said seven days, such respective penalties to be recovered by any person who will sue for the same, with full costs of suit in any of the superior Courts.

Accounts to be Lodged.

38. And with respect to the yearly receipt and expenditure of the Undertakers, be it enacted, that the Undertakers shall, in each year after they have begun to supply gas under the provisions of this or the special Act, cause an account in abstract to be prepared of the total receipts and expenditure of all rents or funds levied under the powers of this or the special Act for the year preceeding, under the several distinct heads of receipt and expenditure, with a statement of the balance of such account, duly audited, and certified by the chairman of the Undertakers, and also by the Auditors thereof, if any; and a copy of such annual account, if the gasworks be situated in *England* or *Ireland*, shall be transmitted, free of charge, to the Clerk of the Peace for the county in which the gasworks are situate, and if the gasworks be situated in *Scotland*, such copy shall be transmitted, free of charge as aforesaid, to the Sheriff Clerk of such county, and such transmission shall be made on or before the thirty-first day of *January* in each year, under a penalty of twenty pounds for each default; and a copy of such account so sent to the said Clerk of the Peace or Sheriff Clerk shall be kept by him, and shall be open to inspection by all persons at all reasonable hours on payment of one shilling for each inspection.

(b) The Gas Works Clauses Act, 1871.*Accounts.*

35. The Undertakers shall fill up and forward to the Local Authority of every district within the limits of the special Act, on or before the twenty-fifth day of March in each year, an annual statement of accounts, made up to the thirty-first day of December then next preceeding, as near as may be in the form and containing the particulars specified in Schedule B. to this Act annexed.

The Undertakers shall keep copies of such annual statement at their office, and sell the same to any applicant at a price not exceeding one shilling for each such copy.

The Board of Trade, with the consent of the Undertakers, may alter the said forms for the purpose of adapting them to the circumstances of the Undertaking, or of better carrying into effect the objects of this section.

(c) Forms of Accounts prescribed by Gas Works Clauses Act, 1871.

THE GAS COMPANY. —Year ended 31st December, 19 .

A.—STATEMENT OF SHARE CAPITAL on the 31st December, 19 .

1 Description of Capital.	2 Maximum Dividend authorised.	3 Number of Shares issued.	4 Nominal Amount of Share.	5 Called up per Share.	6 Total paid up.	7 Amount issued but not paid up.	8 Remain- ing to be issued.	9 Total Amounts author- ised.

B.—STATEMENT OF LOAN CAPITAL on the 31st December, 19

1	2	3	4	5
Description of Loan (Mortgage, Bond, Debenture, Stock, &c.)	Rate per Cent of Interest	Total Amounts borrowed at 31st December, 19	Remaining to be borrowed	Total Amounts authorized

Total Share Capital paid up (sec A)

Do. Loan do borrowed (see B)

Total Capital received

C -CAPITAL ACCOUNT for the Year ended 31st December, 19

Expenditure to 31st Dec 19										Expended this Year										Total to 31st Dec 19										Certified Receipts 31st Dec 19										Received during Year										Total Receipts to 31st Dec 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D.—REVENUE ACCOUNT for the Year ended 31st December, 19

	£	s.	d.	£	s.	d.		£	s.	d.	£	s.	d.
To Manufacture of Gas.							By Sale of Gas.						
1. Coals, including Dues, Carriage, Unloading, and all Expenses of depositing same on Works ..							1. Common Gas (cubic feet), at / per 1,000 cubic feet ..						
2. Purifying Materials, Oil, Water, and Sundries at Works ..							2. Cannel Gas (cubic feet), at / per 1,000 cubic feet ..						
3. Salaries of Engineers, including Chief Engineer (if any), Superintendents, and Officers at Works ..							3. Public Lighting and under Contracts ..						
4. Wages and Gratuities at Works ..							4. Rental of Meters ..						
5. Repairs and Maintenance of Works and Plant (including Renewal of Retorts), Machines, Apparatus, Tools, Materials, and Labour ..							By Residual Products.						
Less Old Material sold ..							5. Coke, less Labour and Cartage ..						
							6. Breeze, ditto ..						
To Distribution of Gas.							7. Tar, ditto ..						
6. Salaries of Surveyor, Chief Inspector, Inspectors, Assistant Inspectors, and Clerks in Light Office ..							8. Ammoniacal Liquor, ditto ..						
7. Repair, Maintenance, and Renewal of Mains, and of Service Pipes, including Materials, Laying and Paving, and Labour ..							9. By Rents ..						
8. Repairing, Renewing, and Refixing Meters ..							10. By Transfer Fees ..						
To Public Lamps.							By other Items (if any) ..						
9. Lighting and Repairing ..													
To Rents, Rates, and Taxes.													
10. Rents ..													
11. Rates and Taxes ..													
To Management.													
12. Directors' Allowances ..													
13. Salaries of Secretary, Accountant and Clerks, Office Keepers, and Messengers ..													
14. Collectors' Commission or Salaries ..													
15. Stationery and Printing ..													
16. General Establishment Charges and Incidentals ..													
17. Auditor ..													
To Law and Parliamentary Charges.													
18. Law ..													
19. Parliamentary (oppositions) ..													
20. To Depreciation Fund for Works on Leasehold Lands (if any) ..													
21. To Bad Debts ..													
To other Items (if any) ..													
Total Expenditure ..													
Balance carried to Profit and Loss Account E.													
							Total Receipts ..						

E.—PROFIT AND LOSS ACCOUNT (NET REVENUE) for the Year ended 31st December, 19

Dr	£ s d	Cr	£ s d
1 To amount carried to Reserved Fund Account F (if any), from Profits of 19		1 By Balance of Net Profit brought from last Account (31st December, 19)	
2 „ Interest on Temporary Loans, and Monies received in anticipation of Calls		2 „ Amount drawn from Reserved Fund (if any)	
3 „ Ditto on Mortgages and Bonds accrued to 31st December, 19		Less Dividend paid for the Half year ended 31st December 19	
4 „ Ditto on Debenture Stock to ditto		3 Balance brought from Revenue Account D, being Profit for Year to December 19	
5 „ Half year's Dividend on 1st Preferential to 30th June, 19		4 Interest on Monies deposited	
6 „ Ditto, 2nd Preferential to ditto			
7 „ Ditto on Ordinary Shares at per cent			
„ Balance of Net Profit, to be carried to next Account subject to Half year's Dividends to 31st December, 19			
	£		£

F.—RESERVED FUND ACCOUNT for the Year ended 31st December, 19

£ s d	£ s d
1 Amount (if any) carried to Profit and Loss Account L, to make up deficiencies of Dividends to 31st December, 19	1 By Balance brought from last Account
2 Amount Paid for Extraordinary (claim on Demand (if any)	2 „ Balance brought from Profit and Loss Account L
3 Amount of Balance to be carried to next Account	Interest on Amount Invested
£	£

Like Accounts must be given for Depreciation Fund for Works on Leaseholds (if any)

G.—STATEMENT OF COALS during the Year ended 31st December, 19

Description of Coal	In Store 31st December, 19	Received during Year	Carbonized or used during Year	In Store 31st December, 19
	Tons	Tons	Tons	Tons
Common Cannel				

H.—STATEMENT OF RESIDUAL PRODUCTS for the Year ended 31st December, 19

Description of Residual.	In Store 31st December, 19 Estimated.	Made during Year Estimated	Used in Manufacture during Year. Estimated	Sold during Year	In Store 31st December, 19 Estimated.
Coke, Common, chaldrons of 36 bushels					
„ Cannel „ „					
„ „ „ „					
Tar, gallons					
Ammoniacal Liquor, butts of 108 gallons					

I.—GENERAL BALANCE SHEET on 31st December, 19

Dr.	Cr.
£ s. d.	£ s. d.
<p>1. <i>To Capital Account</i>— Balance at Credit thereof (Account C.)</p> <p>2. „ <i>Profit and Loss Account</i>— Balance at Credit thereof (Account E.)</p> <p>3. „ <i>Reserved Fund</i>— Balance at Credit thereof (Account F.)</p> <p>4. „ <i>Depreciation Fund</i> (for Works on Leasehold Lands)— Balance at Credit thereof (Account)</p> <p>5. „ <i>Unpaid Dividends</i></p> <p>6. „ <i>Interest accrued and unpaid</i> on Mortgages, Bonds, and Debenture Stock, and other Loans, to 31st December, 19</p> <p>7. „ <i>Sundry Tradesmen and others,</i> for Amount due for Coals, Stores, &c., to 31st Decem- ber, 19</p> <p>8. „ <i>Wages and Contingencies</i>— Amount due to 31st Decem- ber, 19</p> <p>„ <i>Other Items (if any)</i></p>	<p>1. By Cash at Bankers</p> <p>2. „ Cash on Deposit or at Interest</p> <p>3. „ Coals for Stock, on hand 31st December, 19</p> <p>4. „ Coke and Breeze, 31st December, 19</p> <p>5. „ Tar and other Pro- ducts, 31st Decem- ber, 19</p> <p>6. „ Sundry Stores, 31st December, 19</p> <p>7. „ Gas and Meter Rental; Balance of this Account due to the Company on 31st December, 19, less Deposits and Prepayments</p> <p>8. „ Coke and other Re- siduals, 31st Decem- ber, 19</p> <p>9. „ Sundry Accounts, 31st December, 19</p> <p>„ <i>Special Items (if any), in- cluding Investments</i></p>
£	£

§ 4.—Water Companies.

The Water Works Clauses Act, 1847.

Profits to be Limited.

75. The profits of the Undertakings to be divided among the Undertakers in any year shall not exceed the prescribed rate, or where no rate is prescribed, they shall not exceed the rate of ten pounds in the hundred by the year on the paid-up capital in the Undertaking, which in such case shall be deemed the prescribed rate, unless a larger dividend be at any time necessary to make up the deficiency of any previous dividend which shall have fallen short of the said yearly rate.

Reserved Fund.

76. If the clear profits of the Undertaking in any year amount to a larger sum than is sufficient, after making up the deficiency in the dividends of any previous year as aforesaid, to make a dividend at the prescribed rate, the excess beyond the sum necessary for such purpose shall from time to time be invested in Government or other securities, and the dividends and interest arising from such securities shall also be invested in the same or like securities, in order that the same may accumulate at compound interest until the fund so formed amounts to the prescribed sum, or, if no sum be prescribed, to a sum equal to one-tenth part of the nominal capital of the Undertakers, which sum shall form a reserved fund to answer any deficiency which may at any time happen in the amount of divisible profits, or to meet any extraordinary claim or demand which may at any time arise against the Undertakers; and if such fund be at any time reduced,

it may thereafter be again restored to the said sum, and so from time to time as often as such reduction shall happen.

77. Provided always, that no sum of money shall be taken from the said fund for the purpose of meeting any extraordinary claim, unless it be first certified, in *England or Ireland* by two Justices, and in *Scotland* by the Sheriff, that the sum so proposed to be taken is required for the purpose of meeting any extraordinary claim within the meaning of this or the special Act.

78. When such fund shall, by accumulation or otherwise, amount to the prescribed sum, or one-tenth part of the nominal capital, as the case may be, the interest and dividends thereon shall no longer be invested, but shall be applied to any of the general purposes of the Undertaking to which the profits thereof are applicable.

79. If in any year the profits of the Undertaking divisible amongst the Undertakers shall not amount to the prescribed rate, such a sum may be taken from the reserved fund as, with the actual divisible profits of such year, will enable the Undertakers to make a dividend of the amount aforesaid, and so from time to time as often as the occasion shall require.

Accounts to be Lodged.

83. And with respect to the yearly receipt and expenditure of the Undertakers, be it enacted, that the Undertakers shall, in each year after they have begun to supply water under this or the special Act, cause an account in abstract to be prepared of the whole receipt and expenditure of all rates or other moneys levied under the powers of this or the special Act for the year preceding, under the several distinct heads of Receipt and Expenditure, with a statement of the balance of such account, duly audited and certified by the chairman of the Undertakers, and also by the Auditors thereof, if any; and a copy of such annual account shall be sent, free of charge, to the Clerk of the Peace for the County in which the Waterworks are situated, if the Waterworks are situated in *England or Ireland*, and if the Waterworks are situated in *Scotland* to the Sheriff Clerk of such County, on or before the thirty-first day of *January* in each year.

§ 5.—Electric Lighting Companies.

(a) The Electric Lighting Act, 1882.

Accounts.

9. The Undertakers shall, on or before the twenty-fifth day of March in every year, fill up an annual statement of accounts of the Undertaking made up to the thirty-first day of December then next preceding; and such statement shall be in such form and shall contain such particulars and shall be published in such manner as may from time to time be prescribed in that behalf by the Board of Trade.

The Undertakers shall keep copies of such annual statement at their office, and sell the same to any applicant at a price not exceeding one shilling a copy.

(b) Form of Accounts prescribed for Electric Lighting Companies.

.....ELECTRIC LIGHTING ORDER (LICENCE).
COMPANY.

THE

Year ending 31st December, 19 ..

STATEMENT OF SHARE CAPITAL APPROPRIATED FOR THE PURPOSES OF THE UNDERTAKING
AUTHORISED BY THE ABOVE-MENTIONED ORDER (LICENCE)

No. I.

on the 31st December, 19 ..

Description of Capital.	Authorised by	Number of Shares issued.	Nominal Amount of Share.	Called up per Share.	Total Paid up.	Issued, not Paid up.	Remaining Unissued.	Total Amount Authorised.

STATEMENT OF LOAN CAPITAL APPROPRIATED FOR THE PURPOSES OF THE UNDERTAKING
AUTHORISED BY THE ABOVE-MENTIONED ORDER (LICENCE)

No. II.

on the 31st December, 19 ..

Description of Loan.	Amounts Borrowed.		Remaining Borrowing Powers.	Total Amount of Borrowing Powers.
	At %.	At %.		

Total Share Capital Paid up, see No. I. .. £
 " Loan " Borrowed, see No. II... .. £
 Total Capital received £

Dr.

CAPITAL ACCOUNT

for the Year ending 31st December, 19 .

* No. III.

	Expenditure up to 31 Dec., 19			Expended during the year.			Total Expenditure to 31 Dec., 19 .			Receipts up to 31 Dec., 19			Receipts during Year.			Total Receipts to 31 Dec., 19 .		
	£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.
<i>To expenditures to 31 Dec., 19 .</i>																		
<i>Expenditure since that date.</i>																		
1. To Lands, including Law Charges incidental to acquisition																		
2. To Buildings																		
3. To Machinery																		
4. To Accumulators at Generating and Distributing Stations ..																		
5. To Mains, including cost of laying the Mains ..																		
6. To Transformers, Motors, &c.																		
7. To Meters, and Fees for certifying under the Act																		
8. To Electrical Instruments, &c.																		
9. To General Stores (Cable, Mains Lamps)																		
10. To Purchase of Patents or Patent Rights																		
11. To Cost of Licence, Provisional Order, &c. ..																		
12. To Special Items																		
Total Expenditure ..																		
To Balance of Capital Account																		

Provision for depreciation of works is made by a debit of £ . to Revenue Account, transferred to Depreciation Fund Account No. VII.

Dr.		Cr.																					
No. IV.																							
-REVENUE ACCOUNT																							
for the Year ending 31st December, 19																							
£	s. d.	£	s. d.																				
A.—To generation of Electricity. 1. To Coals or other Fuel, including Dues, Carriage, Unloading, Storing, and all Expenses of placing the same on the works 2. To Oil, Waste, Water, and Engine-room Stores 3. To proportion of Salaries of Engineers, Superintendents, and Officers, as certified by the Managing Director, Chairman, or Engineer 4. To Wages and Gratuities at Generating Stations 5. To Repairs and Maintenance, as follows:— <table> <tr> <td>1. Buildings</td><td>£</td><td>s</td><td>d</td></tr> <tr> <td>2. Engines, Boilers</td><td></td><td></td><td></td></tr> <tr> <td>3. Dynamos, Exciters, Transformers, Motors, &c. ..</td><td></td><td></td><td></td></tr> <tr> <td>4. Other Machinery, Instruments, and Tools</td><td></td><td></td><td></td></tr> <tr> <td>5. Accumulators and Accessories</td><td></td><td></td><td></td></tr> </table>		1. Buildings	£	s	d	2. Engines, Boilers				3. Dynamos, Exciters, Transformers, Motors, &c. ..				4. Other Machinery, Instruments, and Tools				5. Accumulators and Accessories				1. By Sale of Current per Meter, at per B.T.U. 2. By Sale under Contracts 3. By Public Lighting 4. By Rental of Meters and other Apparatus on Consumers' Premises 5. By Sale and Repairs of Lamps, Arc or Incandescent By Sale and Repairs of other Apparatus 6. By Royalties, Licences, &c. 7. By Rents Receivable 8. By Transfer Fees 9. By other Items (to be specified)	
1. Buildings	£	s	d																				
2. Engines, Boilers																							
3. Dynamos, Exciters, Transformers, Motors, &c. ..																							
4. Other Machinery, Instruments, and Tools																							
5. Accumulators and Accessories																							
Less received for Old Material 6. To Special Items		Carried forward																					
B.—To Distribution of Electricity. 1. To proportion of Salaries of Superintendents and Officers, as certified by Managing Director, Chairman, or Engineer 2. To Wages and Gratuities to Linesmen, Fitters, Labourers		Carried forward																					

Dr.		REVENUE ACCOUNT—continued.				Cr.	
No. IV.—continued.		£	s	d	£	s	d
		Brought over				..	
3.	To Repairs, Maintenance, and Renewals of Mains of all classes, including Materials and laying the same Less amounts refunded ..						
4.	To Repairs, Maintenance, and Renewals of Transformers, Meters, Switches, Fuses, and other Apparatus in Consumers' premises						
5.	To Repairs, Maintenance, and Renewals of Apparatus at Distributing Stations ..						
C.—To Public Lamps							
1.	To Attending and Repairs ..						
2.	To Renewals of Lamps ..						
D.—To Royalties, &c.							
1.	To Royalties &c. payable for use of Patents or Patent Processes ..						
E.—To Rents, Rates and Taxes							
1.	To Rents Payable ..						
2.	To Rates and Taxes ..						
F.—To Management Expenses.							
1.	To Directors' Remuneration ..						
2.	To Salaries of Managing Engineers, Secretary, Accountants, Clerks, Messengers, as certified by Managing Director, Chairman, or Engineer ..						
3.	To Salaries or Commissions of Collectors ..						
4.	To Stationery and Printing ..						
6.	To General Establishment Charges ..						
6.	To Auditors of Company ..						
		Carried forward				..	
		Brought over				..	
		Carried forward				..	

REVENUE ACCOUNT—continued

Dr
No. IV.—continued.

	£	s	d	£	s	d	£	s	d
7 To Auditor appointed under the provisions of the Order									
8 To Law and Parliamentary Charges									
1 To Law Expense,									
H—To Depreciation									
1 To Depreciation in respect of Leasehold Works									
2 To Depreciation in respect of Buildings									
3 To Depreciation in respect of Plant Machinery &c.									
I—To Special Charges									
1 To Insurance, Salaries, &c.									
2 To Expenses for Certification of Officers									
Total Expenditure									
Balance carried to Net Revenue									

Brought over

£

£

NET REVENUE ACCOUNT.

Cr.

Dr.

No. V.

	£	s	d	£	s	d
1. To Interest on Debentures accrued due to date ..				1 By Balance from last Account ..		
2. To Interest on Mortgages and Bonds accrued due to date ..				Less Dividend paid ..	£	s d
3. To Interest on Temporary Loans accrued due to date ..				By Amount carried to Reserve Fund ..		
4. To Dividend on Preference Stocks						
5. To Balance applicable to Dividend on Ordinary Stock or Shares				2 By Balance brought from Revenue Account (No IV) ..		
				3 By Interest on Money at Deposit ..		

£

RESERVE FUND ACCOUNT.

Dr.

No. VI.

Cr.

	£	s.	d.	£	s.	d.
1. Amount paid out for	1. By Balance brought from last Account .. .. .	..	..
2. Amount of Balance to next Account	2. By Amount brought from Net Revenue Account .. .. .	..	..
				3. By Interest on Amount Invested .. .. .	..	..
				(Description of Investments to be specified.)		
	£				£	

DEPRECIATION FUND ACCOUNT.

Dr.

No. VII.

Cr.

	£	s.	d.	£	s.	d.
1. To Balance	1 By Balance from last Account .. .. .	..	..
				2. By Interest on Investments .. .. .	..	..
				3. By Amount brought from Revenue Account (see No. IV. H.)		
				(Description of Investments to be specified.)		
	£				£	

Cr.

GENERAL BALANCE SHEET.

Dr.

No. VIII.

		£	s.	d.			£	s.	d.
<i>Liabilities.</i>					<i>Assets.</i>				
1. To Capital Account: Amount Received, as per Account No. III	1. By Capital Account: Amount Expended for Works, as per Account No. III .. ..	..	..	..	..
2. To Sundry Tradesmen and other- due on Construction of Plant and Machinery, Fuel, Stores, &c. to 31st December, 19	2. By Stores on Hand at 31st December, 19	£	s.	d.	..
3. To Sundry Creditors on Open Accounts	Coal, Waste, &c. .. ..	..	..	..	..
4. To Net Revenue Account: Balance at Credit there 1	Oil, General .. ..	..	..	..	..
5. To Reserve Fund Account	3. By Sundry Debtors, for Amounts Paid on account of Contracts in course of completion .. ..	..	..	..	..
6. To Depreciation Fund Account	4. By Preliminary Expenses .. ..	..	..	..	..
					5. By Sundry Debtors, for Current supplied to 31st December, 19 .. ..	..	..	..	..
					6. By Other Debtors .. ..	..	..	..	..
					7. By Cash at Bankers — .. ..	..	..	..	..
					Messrs .. ..	..	..	..	£ s d
					Messrs (Amount on Deposit) .. ..	..	..	..	..
					8. By Cash in Hand .. ..	..	..	..	..
									£

Chairman.

Manager and Secretary.

March, 19 ..

(c) **The Electric Lighting (Clauses) Act, 1899.***Application of Act.*

1. The provisions contained in the Schedule to this Act shall be incorporated with and form part of every Provisional Order made by the Board of Trade after the commencement of this Act under the Electric Lighting Acts, save so far as they are expressly varied or excepted by the Order, and shall, subject to any such variations or exceptions, apply, so far as applicable, to the undertaking authorised by the Order.

The said provisions shall also, with the necessary modifications, and in particular with the substitution of the words "special Act" for "special Order" be incorporated with any special Act, save so far as they are expressly varied or excepted thereby.

*Schedule.**Audit.*

6. The following provisions shall apply as to the audit of accounts where the Undertakers are not a Local Authority : -

- (1) The annual statement of accounts of the Undertaking, before being published, as provided by Section nine of the Electric Lighting Act, 1882, shall be examined and audited by such competent and impartial person as the Board of Trade appoint, and the remuneration of the Auditor shall be such as the Board of Trade direct, and that remuneration and all expenses incurred by him in or about the execution of his duties, to such an amount as the Board of Trade approve, shall be paid by the Undertakers on demand, and shall be recoverable summarily as a civil debt.
- (2) The Undertakers shall give to the Auditor, his clerks and assistants, access to such of the books and documents relating to the Undertaking as are necessary for the purposes of the audit, and shall when required furnish to him and them all vouchers and information requisite for that purpose, and shall afford to him and them all facilities for the proper execution of his and their duty.
- (3) The Board of Trade may make and vary regulations prescribing the times at and the mode in which the audit shall be made and conducted, or otherwise for the purpose of giving effect to the provisions of this section.
- (4) Any report made by the Auditor, or such portion thereof as the Board of Trade direct, shall be appended to the annual statement of accounts, and shall form part thereof for the purposes of the said Section nine.

§ 6.—Assurance Companies.

(a) The Assurance Companies Act, 1909.

Application of Act.

1. This Act shall apply to all persons or bodies of persons, whether corporate or unincorporate, not being registered under the Acts relating to Friendly Societies or to Trade Unions (which persons and bodies of persons are hereinafter referred to as Assurance Companies), whether established before or after the commencement of this Act, and whether established within or without the United Kingdom, who carry on within the United Kingdom assurance business of all or any of the following classes :—

- (a) Life assurance business; that is to say, the issue of, or the undertaking of liability under, policies of assurance upon human life, or the granting of annuities upon human life;
- (b) Fire insurance business; that is to say, the issue of, or the undertaking of liability under, policies of insurance against loss by or incidental to fire;
- (c) Accident insurance business; that is to say, the issue of, or the undertaking of liability under, policies of insurance upon the happening of personal accidents, whether fatal or not, disease, or sickness, or any class of personal accidents, disease, or sickness;
- (d) Employers' liability insurance business; that is to say, the issue of, or the undertaking of liability under, policies insuring employers against liability to pay compensation or damages to workmen in their employment;
- (e) Bond investment business; that is to say, the business of issuing bonds or endowment certificates by which the Company, in return for subscriptions, payable at periodical intervals of two months or less, contract to pay the bondholder a sum at a future date, and not being life assurance business as hereinbefore defined:

subject as respects any class of assurance business to the special provisions of this Act relating to business of that class.

A Company registered under the Companies Acts which transacts assurance business of any such class as aforesaid in any part of the world shall for the purposes of this provision be deemed to be a Company transacting such business within the United Kingdom.

Deposit.

2.—(1) Every Assurance Company shall deposit and keep deposited with the Paymaster-General for and on behalf of the Supreme Court the sum of twenty thousand pounds.

(2) The sum so deposited shall be invested by the Paymaster-General in such of the securities usually accepted by the Court for the investment of funds placed under its administration as the Company

may select, and the interest accruing due on any such securities shall be paid to the Company.

(3) The deposits may be made by the subscribers of the Memorandum of Association of the Company, or any of them, in the name of the proposed Company, and, upon the incorporation of the Company, shall be deemed to have been made by, and to be part of the assets of, the Company, and the Registrar shall not issue a certificate of incorporation of the Company until the deposit has been made.

(4) Where a Company carries on, or intends to carry on, assurance business of more than one class, a separate sum of twenty thousand pounds shall be deposited and kept deposited under this section as respects each class of business, and the deposit made in respect of any class of business in respect of which a separate assurance fund is required to be kept shall be deemed to form part of that fund, and all interest accruing due on any such deposit on the securities in which it is for the time being invested shall be carried by the Company to that fund.

(5) The Paymaster-General shall not accept a deposit except on a warrant of the Board of Trade.

(6) The Board of Trade may make rules with respect to applications for warrants, the payment of deposits, and the investment thereof or dealing therewith, the deposit of stocks or other securities in lieu of money, the payment of the interest or dividends from time to time accruing due on any securities in which deposits are for the time being invested, and the withdrawal and transfer of deposits, and the rules so made shall have effect as if they were enacted in this Act, and shall be laid before Parliament as soon as may be after they are made.

(7) This section shall apply to an Assurance Company registered or having its head office in Ireland, subject to the following modifications:—

References to the Supreme Court shall be construed as references to the Supreme Court of Judicature in Ireland, and references to the Paymaster-General shall be construed as references to the Accountant-General of the last mentioned Court.

Separation of Funds.

3.—(1) In the case of an Assurance Company transacting other business besides that of assurance, or transacting more than one class of assurance business, a separate account shall be kept of all receipts in respect of the assurance business or of each class of assurance business, and the receipts in respect of the assurance business or, in the case of a Company carrying on more than one class of assurance business, of each class of business, shall be carried to and form a separate assurance fund with an appropriate name: Provided that nothing in this section shall require the investments of any such fund to be kept separate from the investments of any other fund.

(2) A fund of any particular class shall be as absolutely the security of the Policy Holders of that class as though it belonged to a Company carrying on no other business than assurance business of that class,

and shall not be liable for any contracts of the Company for which it would not have been liable had the business of the Company been only that of assurance of that class, and shall not be applied, directly or indirectly, for any purposes other than those of the class of business to which the fund is applicable.

Accounts and Balance Sheets.

4. Every Assurance Company shall, at the expiration of each financial year of the Company, prepare—

- (a) A Revenue Account for the year in the form or forms set forth in the First Schedule to this Act and applicable to the class or classes of assurance business carried on by the Company ;
- (b) A Profit and Loss Account in the form set forth in the Second Schedule to this Act, except where the Company carries on assurance business of one class only and no other business ;
- (c) A Balance Sheet in the form set forth in the Third Schedule to this Act.

Actuarial Report and Abstract.

5.—(1) Every Assurance Company shall, once in every five years, or at such shorter intervals as may be prescribed by the instrument constituting the Company, or by its regulations or bye-laws, cause an investigation to be made into its financial condition, including a valuation of its liabilities, by an Actuary, and shall cause an abstract of the report of such Actuary to be made in the form or forms set forth in the Fourth Schedule to this Act and applicable to the class or classes of assurance business carried on by the Company.

(2) The foregoing provisions of this section shall also apply whenever at any other time an investigation into the financial condition of an Assurance Company is made with a view to the distribution of profits, or the results of which are made public.

Statement of Assurance Business.

6. Every Assurance Company shall prepare a statement of its assurance business at the date to which the accounts of the Company are made up for the purposes of any such investigation as aforesaid in the form or forms set forth in the Fifth Schedule to this Act and applicable to the class or classes of assurance business carried on by the Company: Provided that, if the investigation is made annually by any Company, the Company may prepare such a statement at any time, so that it be made at least once in every five years.

Deposit of Accounts, &c., with Board of Trade.

7.—(1) Every Account, Balance Sheet, Abstract, or Statement herebefore required to be made shall be printed, and four copies thereof, one of which shall be signed by the Chairman and two Directors of the Company and by the principal Officer of the Company, and if the Company has a Managing Director by the Managing Director, shall

be deposited at the Board of Trade within six months after the close of the period to which the Account, Balance Sheet, Abstract, or Statement relates: Provided that, if in any case it is made to appear to the Board of Trade that the circumstances are such that a longer period than six months should be allowed, the Board may extend that period by such period not exceeding three months as they think fit.

(2) The Board of Trade shall consider the Accounts, Balance Sheets, Abstracts, and Statements so deposited, and, if any such Account, Balance Sheet, Abstract, or Statement appears to the Board to be inaccurate or incomplete in any respect, the Board shall communicate with the Company with a view to the correction of any such inaccuracies and the supply of deficiencies.

(3) There shall be deposited with every Revenue Account and Balance Sheet of a Company any Report on the affairs of the Company submitted to the Shareholders or Policy Holders of the Company in respect of the financial year to which the account and Balance Sheet relates.

(4) Where an Assurance Company registered under the Companies Acts in any year deposits its Accounts and Balance Sheet in accordance with the provisions of this section, the Company may, at the same time, send to the Registrar a copy of such Accounts and Balance Sheet; and, where such copy is so sent, it shall not be necessary for the Company to send to the Registrar a Statement in the form of a Balance Sheet, as required by Subsection (3) of Section twenty-six of the Companies (Consolidation) Act, 1908, and the copy of the Accounts and Balance Sheet so sent shall be dealt with in all respects as if it were a Statement sent in accordance with that subsection.

8. A printed copy of the last deposited Accounts, Balance Sheet, Abstract, or Statement, shall on the application of any Shareholder or Policy Holder of the Company be forwarded to him by the Company by post or otherwise.

Audit.

9. Where the Accounts of an Assurance Company are not subject to Audit in accordance with the provisions of the Companies (Consolidation) Act, 1908, or the Companies Clauses Consolidation Act, 1845, relating to Audit, the accounts of the Company shall be audited annually in such manner as the Board of Trade may prescribe, and the regulations made for the purpose may apply to any such Company the provisions of the Companies (Consolidation) Act, 1908, relating to Audit, subject to such adaptations and modifications as may appear necessary or expedient.

Shareholders' Address Book.

10. Every Assurance Company which is not registered under the Companies Acts, or which has not incorporated in its Deed of Settlement Section ten of the Companies Clauses Consolidation Act, 1845, shall keep a "Shareholders' Address Book," in accordance

with the provisions of that Section, and shall, on the application of any Shareholder or Policy Holder of the Company, furnish to him a copy of such book, on payment of a sum not exceeding sixpence for every hundred words required to be copied.

Alteration of Forms.

22. The Board of Trade may, on the application or with the consent of an Assurance Company, alter the forms contained in the Schedules to this Act as respects that Company, for the purpose of adapting them to the circumstances of that Company.

Penalties.

23. Any Assurance Company which makes default in complying with any of the requirements of this Act shall be liable to a penalty not exceeding one hundred pounds, or, in the case of a continuing default, to a penalty not exceeding fifty pounds for every day during which the default continues, and every Director, Manager, or Secretary, or other Officer or Agent of the Company who is knowingly a party to the default shall be liable to a like penalty.

24. If any Account, Balance Sheet, Abstract, Statement, or other document required by this Act is false in any particular to the knowledge of any person who signs it, that person shall be guilty of a misdemeanour and shall be liable on conviction on indictment to fine and imprisonment, or on summary conviction to a fine not exceeding fifty pounds.

Application to Underwriters.

28.—(2) This Act shall not apply to a member of Lloyd's, or of any other association of underwriters approved by the Board of Trade, who carries on assurance business of any class, provided that he complies with the requirements set forth in the Eighth Schedule to this Act, and applicable to business of that class.

Application to Fire Insurance Companies.

31. Where a Company carries on fire insurance business, this Act shall apply with respect to that business, subject to the following modifications :—

- (a) It shall not be necessary for the Company to prepare any statement of its fire insurance business in accordance with the Fourth and Fifth Schedules to this Act :
- (b) Such of the provisions of this Act as relate to deposits to be made under this Act shall not apply with respect to the fire insurance business carried on by the Company, if the Company has commenced to carry on that business within the United Kingdom before the passing of this Act :
- (c) Such of the provisions of this Act as relate to deposits to be made under this Act shall not apply where the Company is an association of owners or occupiers of buildings or other

property which satisfies the Board of Trade that it is carrying on, or is about to carry on, business wholly or mainly for the purpose of the mutual insurance of its members against damage by or incidental to fire caused to the houses or other property owned or occupied by them :

- (d) It shall not be necessary to make a deposit in respect of fire insurance business where the Company has made a deposit in respect of any other class of assurance business, and, where a Company, having made a deposit in respect of fire insurance business, commences to carry on life assurance business or employers' liability insurance business, the Company may transfer the deposit so made to the account of that other business, and after such transfer the deposit shall be treated as if it had been made in respect of such other business :
- (e) So much of this Act as requires an Assurance Company transacting other business besides assurance business, or more than one class of assurance business, to keep separate funds into which all receipts in respect of the assurance business or of each class of assurance business are to be paid shall not apply as respects fire insurance business.

Application to Accident Insurance Companies.

32. Where a Company carries on accident insurance business, this Act shall apply with respect to that business, subject to the following modifications :—

- (a) In lieu of the provisions of Sections five and six of this Act the following provisions shall be substituted :—

“The Company shall annually prepare a statement of its accident insurance business in the form set forth in the Fourth Schedule to this Act and applicable to accident insurance business, and the statement shall be printed, signed, and deposited at the Board of Trade in accordance with Section seven of this Act” :
- (b) Such of the provisions of this Act as relate to deposits to be made under this Act shall not apply with respect to the accident insurance business carried on by the Company if the Company has commenced to carry on that business in the United Kingdom before the passing of this Act :
- (c) It shall not be necessary to make or keep a deposit in respect of accident insurance business where the Company has made a deposit in respect of any other class of assurance business, and, where a Company, having made a deposit in respect of accident insurance business, commences to carry on life assurance business or employers' liability insurance business, the Company may transfer the deposit so made to the account of that other business, and after such transfer the deposit shall be treated as if it had been made in respect of such other business :

- (d) So much of this Act as requires an Assurance Company transacting other business besides assurance business, or more than one class of assurance business, to keep separate funds into which all receipts in respect of the assurance business or of each class of assurance business are to be paid shall not apply as respects accident insurance business.

Application to Employers' Liability Insurance Companies.

33.—(1) Where a Company carries on employers' insurance business, this Act shall apply with respect to that business, subject to the following modifications :—

- (a) This Act shall not apply where the Company is an association of employers which satisfies the Board of Trade that it is carrying on, or is about to carry on, business wholly or mainly for the purpose of the mutual insurance of its members against liability to pay compensation or damages to workmen employed by them, either alone or in conjunction with insurance against any other risk incident to their trade or industry :
- (b) This Act shall not apply where the Company carries on the employers' liability insurance business as incidental only to the business of marine insurance by issuing marine policies, or policies in the form of marine policies, covering liability to pay compensation or damages to workmen as well as losses incident to marine adventure or adventure analogous thereto :
- (c) In lieu of the provisions of Sections five and six of this Act the following provisions shall be substituted :—

“ The Company shall annually prepare a statement of its employers' liability insurance business in the form set forth in the Fourth Schedule to this Act and applicable to employers' liability insurance business, and shall cause an investigation of its estimated liabilities to be made by an Actuary so far as may be necessary to enable the provisions of that form to be complied with, and the statement shall be printed, signed, and deposited at the Board of Trade in accordance with Section seven of this Act.”

- (d) Such of the provisions of this Act as relate to deposits to be made under this Act shall not apply with respect to the employers' liability insurance business carried on by a Company where the Company had commenced to carry on that business within the United Kingdom before the twenty-eighth day of August, nineteen hundred and seven :
- (e) As soon as the employers' liability fund set apart and secured for the satisfaction of the claims of Policy Holders of that class amounts to forty thousand pounds, the Paymaster-General shall, if the Company has made a deposit in respect of any other class of assurance business, return to the Company the money deposited in respect of its employers' liability insurance business, and it shall not thereafter be necessary

for the Company to keep any sum deposited in respect of that business, so long as the sum deposited in respect of any other class of assurance business is kept deposited :

- (f) Where money is paid into a County Court under the provisions of the Eighth Schedule to this Act, the Court shall (unless the Court for special reason sees fit to direct otherwise) order the lump sum to be invested or applied in the purchase of an annuity or otherwise, in such manner that the duration of the benefit thereof may, as far as possible, correspond with the probable duration of the incapacity.

Application to Bond Investment Companies.

34. Where a Company carries on bond investment business, this Act shall apply with respect to that business, subject to the following modifications :—

- (a) The expression " Policy " includes any bond, certificate, receipt, or other instrument evidencing the contract with the Company, and the expression " Policy Holder " means the person who for the time being is the legal holder of such instrument :
- (b) Such of the provisions of this Act as relate to deposits shall not apply with respect to the bond investment business carried on by the Company, if the Company has commenced to carry on that business in the United Kingdom before the passing of this Act :
- (c) As soon as the bond investment fund set apart and secured for the satisfaction of the claims of the Policy Holders of that class amounts to forty thousand pounds, the Paymaster-General shall, if the Company has made a deposit in respect of any other class of assurance business, return to the Company the money deposited in respect of its bond investment business, and it shall not thereafter be necessary for the Company to keep any sum deposited in respect of that business, so long as the sum deposited in respect of any other class of business is kept deposited :
- (d) The first statement of the bond investment business of the Company shall be deposited at the Board of Trade on or before the thirtieth day of June, nineteen hundred and eleven.

EIGHTH SCHEDULE.

REQUIREMENTS TO BE COMPLIED WITH BY UNDERWRITERS BEING MEMBERS OF LLOYD'S, OR OF ANY OTHER ASSOCIATION OF UNDERWRITERS APPROVED BY THE BOARD OF TRADE.

(A)—*As respects Life Assurance Business.*

1. Every underwriter shall deposit and keep deposited in such manner as the Board of Trade may direct a sum of two thousand pounds. The Board of Trade may make rules as to the payment, repayment, investment of, and dealing with, a deposit, the payment of interest and dividends from any such investment, and for any other matters in respect of which they may make rules under section 2 (6) of this Act in relation to deposits made by assurance companies. The sum so deposited shall, so long as any liability under any policy issued by the underwriter remains unsatisfied, be available solely to meet claims under such policies.

2. The underwriter shall furnish every year to the Board of Trade a statement in such form as may be prescribed by the Board showing the extent and character of the life assurance business effected by him.

(B) and (C)—*As respects Fire and Accident Insurance Business.*

1. Except as hereinafter provided, every underwriter shall comply with the following requirements :—

(a) He shall deposit and keep deposited in such manner as the Board of Trade may direct a sum of two thousand pounds in respect of each class of business. The Board of Trade may make rules as to the payment, repayment, investment of, and dealing with, a deposit, the payment of interest and dividends from any such investment, and for any other matters in respect of which they may make rules under section 2 (6) of this Act in relation to deposits made by assurance companies. The sum so deposited shall, so long as any liability under any policy issued by the underwriter remains unsatisfied, be available solely to meet claims under such policies.

(b) He shall furnish every year to the Board of Trade a statement, in such form as may be prescribed by the Board, showing the extent and character of the fire or accident insurance business effected by him.

2. An underwriter who carries on fire insurance or accident insurance business may, in lieu of complying with the above requirements, elect to comply with the under-mentioned conditions :—

(a) All premiums received by or on behalf of the underwriter in respect of fire and accident insurance or re-insurance business carried on by him, either alone or in conjunction with any

other insurance business for which special requirements are not laid down in this Schedule, shall without any apportionment be placed in a trust fund in accordance with the provisions of a trust deed approved by the Board of Trade :

- (b) He shall also furnish security to the satisfaction of the Board of Trade (or, if the Board so direct, to the satisfaction of the committee of the association), which shall be available solely to meet claims under policies issued by him in connexion with fire and accident business and any other non-marine business carried on by him for which special requirements are not laid down in this schedule.

The security may be furnished in the form of either a deposit or a guarantee, or partly in the one form and partly in the other.

The amount of the security to be furnished shall never be less than the aggregate of the premiums received or receivable by the underwriter in the last preceding year in connexion with such fire and accident and other non-marine business :

- (c) The accounts of every underwriter shall be audited annually by an accountant approved by the committee of the association, who shall furnish a certificate to the committee of the association and to the Board of Trade in a form prescribed by the Board of Trade :
- (d) For the purpose of these requirements " non-marine insurance business " means the business of issuing policies upon subject-matters of insurance other than the following, namely :—

Vessels of any description, including barges and dredgers, cargoes, freights, and other interests which may be legally insured by, in, or in relation to vessels, cargoes, and freights, goods, wares, merchandise, and property of whatever description insured for any transit by land or water, or both, and whether or not including warehouse risks or similar risks in addition or as incidental to such transit.

(D)—*As respects Employers' Liability Insurance Business.*

1. Every underwriter shall deposit and keep deposited in such manner as the Board of Trade may direct a sum of two thousand pounds. The Board of Trade may make rules as to the payment, repayment, investment of, and dealing with, a deposit, the payment of interest and dividends from any such investment, and for any other matters in respect of which they may make rules under this Act in relation to deposits made by assurance companies. The sum so deposited shall, so long as any liability under any policy issued by the underwriter remains unsatisfied, be available solely to meet claims under such policies.

2. Where the person insured by any policy issued by an underwriter is liable to make a weekly payment to any workman during the incapacity of the workman, and the weekly payment has continued for

more than six months, the liability therefor shall before the expiration of twelve months from the commencement of the incapacity be redeemed by the payment of a lump sum in accordance with paragraph (17) of the First Schedule to the Workmen's Compensation Act, 1906, and the underwriter shall pay the lump sum into the county court, and shall inform the court that the redemption has been effected in pursuance of the provisions of this schedule.

3. The underwriter shall furnish every year to the Board of Trade a statement in such form as may be prescribed by the Board showing the extent and character of the employers' liability business effected by him.

4. For the purposes of this schedule "policy" means a policy insuring any employer against liability to pay compensation or damages to workmen in his employment.

(E)—*As respects Bond Investment Business.*

1. Every underwriter shall deposit and keep deposited in such manner as the Board of Trade may direct a sum of two thousand pounds. The Board of Trade may make rules as to the payment, repayment, investment of, and dealing with, a deposit, the payment of interest and dividends from any such investment, and for any other matters in respect of which they may make rules under section 2 (6) of this Act in relation to deposits made by assurance companies. The sum so deposited shall, so long as any liability under any policy issued by the underwriter remains unsatisfied, be available solely to meet claims under such policies.

2. The underwriter shall furnish every year to the Board of Trade a statement in such form as may be prescribed by the Board showing the extent and character of the bond investment business effected by him.

(b) Form of Accounts prescribed by the Assurance Companies Act, 1909.

FIRST SCHEDULE

N.B.—Where Marine Insurance business or Sinking Fund or Capital Redemption Insurance business is carried on, the income and expenditure thereof to be stated in like manner in separate accounts. Any additional businesses (including Employers' Liability Insurance business transacted out of the United Kingdom) to be shown in a separate inclusive general account.

(A) — *Form applicable to Life Insurance Business* in respect of Life Assurance Business for the Year ending

REVENUE ACCOUNT of the

Business Within the United Kingdom	Business Out of the United Kingdom	Business Within the United Kingdom	Business Out of the United Kingdom
£	£	£	£
Amount of Life Assurance Income at the beginning of the Year		(Inclusive of Premiums paid by the insured persons in the United Kingdom)	
Premiums —			
Consideration for Annuities granted			
Interest, Dividends, and Rents			
Less Income Tax thereon			
Other Receipts (specify)			

Notes. — 1.—Companies, having separate accounts for annuities, to return the particulars of their annuity business in a separate statement.
 2.—Companies having both Ordinary and Industrial branches, to return the particulars of the business in each department separately.
 3.—Items in this Account to be net amounts after deduction of the amounts paid and received in respect of Re-assurances of the Company's risks.
 4.—If any sum has been received from the Expenses of Management Account and taken credit for in the Balance Sheet as an asset, the sum so deducted to be shown in the above Account.
 5.—If any sum has been paid in the new life assurance effected during the year of account to be appended to the above Account showing separately, as respects business within and business out of the United Kingdom, the number of policies, the total sums assured, the amount received by way of single premium, and the amount of the yearly renewal premium income, the items to be net amounts after deduction of the amounts paid and received in respect of Re-assurances of the Company's risks. The particulars as to yearly renewal premium income need not be furnished in respect of Industrial business of Re-assurances of the Company's risks.
 6.—The columns headed "Business out of the United Kingdom" in the case of Companies having their Head Office in the United Kingdom apply only to business secured through Branch Offices or Agencies out of the United Kingdom.

(B.)—Form applicable to Fire Insurance Business.

REVENUE ACCOUNT of the _____ for the Year ending _____ 19____, in respect of Fire Insurance Business.

	£	s.	d.	£	s.	d.
Amount of Fire Insurance Fund at the beginning of the Year —						
Reserve for Unexpired Risks						
Additional Reserve (if any)						
Premiums						
Interest, Dividends, and Repts.						
Less Income Tax thereon						
Other Receipts (Accounts to be specified)						
Amount of Fire Insurance Fund at the end of the Year, as per Third Schedule —						
Reserve for Unexpired Risks, being						
per cent of Premium Income for the						
Year						
Additional Reserve (if any)						
Claims under Policies Paid and Outstanding						
Commission						
Expenses of Management						
Contributions to Fire Brigades						
Other Payments (Accounts to be specified)						
Amount of Fire Insurance Fund at the end of the Year, as per Third Schedule —						
Reserve for Unexpired Risks, being						
per cent of Premium Income for the						
Year						
Additional Reserve (if any)						

Note 1—Items in this Account to be the net amounts after deduction of the amounts paid and received in respect of Re-insurances of the Company's risks.

Note 2—If any sum has been deducted from the Expenses of Management Account and taken or dit for in the Balance Sheet as an asset, the sum so deducted to be separately shown in the above Account.

REVENUE ACCOUNT of the

Note 1—Items in this Account to be the net amounts after deduction of the amount paid and received in respect of Re-investments of the Company's

(1) —Form applicable to Employers' Liability Insurance Business.

REVENUE ACCOUNT of the
for the Year ending 19 , in respect of Employers' Insurance
Business transacted within the United Kingdom

	£	s	d	£	s	d
Amount of Employers' Liabilities, Insurance Fund at the beginning of the Year — Reserve for Unexpired Risks						
Total estimated Liability in respect of Outstanding Claims						
Additional Reserve (if any)						
Premiums						
Interest, Dividends, and Rents						
Less Income Tax thereon						
Other Receipts (Accounts to be specified)						
						£
Payments under Policies, including Medical and Legal Expenses in connection therewith						
Commission						
Expenses of Management						
Other Payments (Accounts to be specified)						
Amount of Employers' Liability Insurance Fund at the end of the Year, as per Third Schedule — Reserved for Unexpired Risks, being per cent of Premium Income for the Year						£ s d
Total estimated Liability in respect of Outstanding Claims as per Fourth Schedule (D)						
Additional Reserve (if any)						
						£

Note 1.—Items in this Account to be the net amount, after deduction of the amount paid and received in respect of Re-insurances of the Company's risks.
Note 2.—If any sum has been deducted from the Expenses of Management account and taken credit for in the Balance Sheet as an asset, the sum so deducted to be separately shown in the above Account.

Section 4.			SECOND SCHEDULE.			for the Year ending			19 .
PROFIT AND LOSS ACCOUNT OF THE						£ s d.			£ s d.
Balance of last Year's Account	..	..	..	..	..	Dividends and Bonuses to Shareholders	..	..	..
Interest and Dividends not carried to other Accounts		£ s. d				Expenses not charged to other Accounts	..		..
Less Income Tax thereon	..	..				Loss Realised (Accounts to be specified)	..		..
Profits Realised (Accounts to be specified)	..	..				Other Payments (Accounts to be specified)	..		..
Other Receipts (Accounts to be specified)	..	..				Balance, as per Third Schedule	..	..	..
									£

Section 4.			THIRD SCHEDULE.			19 .		
BALANCE SHEET of the			on the					
			£	s.	d	£	s.	d
LIABILITIES.			ASSETS					
Shareholders' Capital paid up (if any)	..	..	Mortgages on Property within the United Kingdom					
Life Assurance Funds* :—			Do. out of the United Kingdom					
Ordinary Branch	..	..	Loans on Parochial and other Public Rates					
Industrial do.	..	..	Do. Life Interests					
Assessing Fund*	..	..	Do. Reversions					
Fire Insurance Fund	..	..	Do. Stocks and Shares					
Accident Insurance Fund	..	..	Do. Company's Policies within their Surrender Values					
Employers' Liability Insurance Fund	..	..	Do. Personal Security					

Bond Investment and Endowment Certificate Fund		
Marine Insurance Fund		
Sinking Fund and Capital Redemption Fund		
Profit and Loss Account		
Other Funds (if any) to be specified		
Claims Admitted or Intimated but not paid†	—	
Life Insurance		
Fire Insurance		
Bond Investment		
Annuities Due and Unpaid		
Other Sums owing by the Company† (to be stated separately under each class of Business)		
Investments:—		
Deposit with the High Court (Securities to be specified)		
British Government Securities		
Municipal and County Securities, United Kingdom		
Indian and Colonial Government Securities		
Do. Provincial		
Do. Municipal		
Foreign Government Securities		
Do. Provincial		
Do. Municipal		
Railways and other Debentures and Debenture Stocks		
Home and Foreign		
Railway and other Preference and Guaranteed Stocks		
Do. Ordinary Stock		
Rent Charges		
Freehold Ground Rent		
Leasehold		
House Property		
Life Interests		
Reversions		
Agents' Balances		
Outstanding Premiums		
Do. Interests Payable and Retained		
Interest Accrued but not Payable		
Bills Receivable		
Cash		
Undeposited		
In Hand and on Current Account		
Other Assets (to be specified)		

* Life Companies having separate Annuity Fund to show amount thereof separately

† These Items are or have been included in the corresponding Items in the First Schedule
Note 1.—When part of the Assets of the Company are specifically deposited, under local laws, in various places out of the United Kingdom, as security to holders of Policies there issued, each such place and the amount compulsorily lodged therein must be specified in respect of each class of business, except that, in the case of Fire, Accident, or Employers' Liability Insurance Business, it shall be sufficient to state the fact that a part of the Assets has been so deposited.

Note 2.—A Balance Sheet in the above form must be rendered in respect of each separate fund for which separate investments are made

Note 3.—The Balance Sheet must state how the values of the Stock Exchange Securities are arrived at, and a Certificate must be appended, signed by the same persons as sign the Balance Sheet, to the effect that in their belief the Assets set forth in the Balance Sheet are in the aggregate fully of the value stated therein, less any Investment Reserve Fund taken into account. In the case of a Company transacting Life Assurance Business or Bond Investment Business, this Certificate is to be given on the occasions only when a statement re-performing valuation under the Fourth Schedule is made.

Note 4.—In the case of a Company required to keep separate funds under Section 3 of this Act, a Certificate must be appended signed by the same persons as signed the Balance Sheet and by the Auditor, to the effect that no part of any such fund has been applied, directly or indirectly, for any purpose other than the class of business to which it is applicable.

§ 7.— Building Societies.

(a) The Building Societies Act, 1874.

Establishment of Societies.

13. Any number of persons may establish a Society under this Act, either terminating or permanent, for the purpose of raising by the subscription of the members a Stock or Fund for making advances to Members out of the funds of the Society, upon security of freehold, copyhold, or leasehold estate by way of mortgage; and any Society under this Act shall, so far as is necessary for the said purpose, have power to hold land, with the right of foreclosure, and may from time to time raise funds by the issue of shares of one or more denominations either paid up in full or to be paid by periodical or other subscriptions, and with or without accumulating interest, and may repay such funds when no longer required for the purposes of the Society. Provided always that any land to which any such Society may become absolutely entitled by foreclosure, or by surrender, or other extinguishment of the right of redemption, shall, as soon afterwards as may be conveniently practicable, be sold or converted into money.

Borrowing Powers.

15. With respect to the borrowing of money by Societies under this Act, the following provisions shall have effect:

- (1) Any Society under this Act may receive deposits or loans at interest, within the limit in this section provided, from the members or other persons, or from corporate bodies, Joint Stock Companies, or from any terminating Building Society, to be applied to the purposes of the Society;
- (2) In a permanent Society the total amount so received on deposit or loan and not repaid by the Society shall not at any time exceed two-thirds of the amount for the time being secured to the Society by mortgages from its members;
- (3) In a terminating Society the total amount so received and not repaid may, either be a sum not exceeding such two-thirds as aforesaid, or a sum not exceeding twelve months' subscriptions on the shares for the time being in force;
- (4) Any deposits with or loans to a Society under this Act, made before the commencement of this Act in accordance with its certified rules, are hereby declared to be valid and binding on the Society, but no further deposits or loans shall be received by such Society, except within the limits provided by this section;
- (5) Every deposit book, or acknowledgment or security of any kind given for a deposit or loan by a Society, shall have printed or written therein or thereon the whole of the fourteenth and fifteenth sections of the present Act.

Matters to be set forth in Rules.

16. The rules of every Society hereafter established under this Act shall set forth :

- (1) The name of the Society and chief office or place of meeting for the business of the Society ;
- (3) The purposes to which the funds of the Society are to be applied, and the manner in which they are to be invested ;
- (6) The manner of appointing, remunerating, and removing the Board of Directors or Committee of Management, Auditors, and other Officers ;
- (8) Provision for an annual or more frequent audit of the accounts, and inspection by the Auditors of the mortgages and other securities belonging to the Society ;
- (11) Provision for the custody of the mortgage deeds and other securities belonging to the Society.
- (12) The power and duties of the Board of Directors, or Committee of Management, and other Officers.

Investment of Surplus Funds.

25. Any Society under this Act may from time to time, as the rules permit, invest any portion of the funds of the Society, not immediately required for its purposes, upon real or leasehold securities, or in the public funds, or in or upon any Parliamentary stock or securities, or in or upon any stock or securities payment of the interest on which is guaranteed by authority of Parliament, or in the case of terminating Societies with other Societies under this Act ; and for the purpose of investments in the public funds or upon security of copyhold or customary estate, the Society, or the Board of Directors or Committee of Management thereof, may from time to time appoint and remove Trustees.

Annual Account.

40. The Secretary or other Officer of every Society under this Act shall, once in every year at least, prepare an account of all the receipts and expenditure of the Society since the preceding statement and a general statement of its funds and effects, liabilities and assets, showing the amounts due to the holders of the various classes of shares respectively, to depositors and creditors for loans, and also the balance due or outstanding on their mortgage securities (not including prospective interest), and the amount invested in the funds or other securities ; and every such account and statement shall be attested by the Auditors, to whom the mortgage deeds and other securities belonging to the Society shall be produced, and such account and statement shall be countersigned by the Secretary or other Officer ; and every member, depositor, and creditor for loans shall be entitled to receive from the Society a copy of such account and statement,

and a copy thereof shall be sent to the Registrar within fourteen days after the annual or other general meeting at which it is presented, and another copy thereof shall be suspended in a conspicuous place in every office of the Society under this Act.

(b) The Building Societies Act, 1894.

Matters to be set forth in Rules.

1. The rules of every Society under the Building Societies Acts established or substituting a new set of rules for its existing rules after the passing of this Act shall set forth --

- (a) The manner in which the stock or funds of the Society is or are to be raised ;
- (b) The terms upon which unadvanced subscription shares are to be issued ; the manner in which the contributions are to be paid to the Society, and withdrawn by the members, with tables, where applicable in the opinion of the Registrar, showing the amount due by the Society for principal and interest separately ;
- (c) The terms upon which paid-up shares, if any, are to be issued and withdrawn, with tables, where applicable in the opinion of the Registrar, showing the amount due by the Society for principal and interest separately ;
- (d) Whether preferential shares are to be issued, and, if so, within what limits ;
- (e) The manner in which advances are to be made and repaid ; the deductions, if any, for premiums, and the conditions upon which a borrower can redeem the amount due from him before the expiration of the period for which the advance was made ; with tables, where applicable in the opinion of the Registrar, showing the amount due from the borrower after each stipulated payment ;
- (f) The manner in which losses are to be ascertained and provided for ;
- (h) Whether the Society intends to borrow money, and, if so, within what limits not exceeding those prescribed by the Building Societies Acts.

Annual Account and Statement.

2.—(1) Every annual account and statement under section forty of the Building Societies Act, 1874, shall be made up to the end of the official year of the Society to which it relates, and shall be in such form, and shall contain such particulars as the Chief Registrar of Friendly Societies may from time to time, with the approval of a Secretary of State, direct, either generally or with respect to any Society or class of Societies. The form of annual account and statement prescribed for

general use by the Chief Registrar under this section, and every alteration of that form, shall as soon as practicable be laid before each House of Parliament, and shall not come into operation until the expiration of forty days from the date at which it is so laid. Provided that every such account and statement shall set forth :

- (a) With respect to mortgages to the Society upon each of which the present debt does not exceed five thousand pounds (not being mortgages where the repayments are upwards of twelve months in arrear, or where the property has for upwards of twelve months been in possession of the Society), the number of all such mortgages, and the aggregate amount owing thereon at the date of the account or statement, such information being given separately in respect of each of the four following classes :
 - (i) Where the debt does not exceed five hundred pounds :
 - (ii) Where the debt exceeds five hundred pounds and does not exceed one thousand pounds :
 - (iii) Where the debt exceeds one thousand pounds and does not exceed three thousand pounds :
 - (iv) Where the debt exceeds three thousand pounds and does not exceed five thousand pounds ; and
- (b) With respect to any other mortgage to the Society, the particulars shown by the appropriate tabular form in the First Schedule to this Act.

(2) Every Auditor, in attesting any such annual account or statement, shall either certify that it is correct, duly vouched, and in accordance with law, or specially report to the Society in what respect he finds it incorrect, unvouched, or not in accordance with law, and shall also certify that he has at that audit actually inspected the mortgage deeds and other securities belonging to the Society, and shall state the number of properties with respect to which deeds have been produced to and actually inspected by him.

(3) A copy of every such annual account and statement shall be sent to the Registrar within fourteen days after the annual or other general meeting at which it is presented, or within three months after the expiration of the official year of the Society, whichever period expires first.

(4) For the purposes of this section the expression " Official year " shall mean, in the case of any Society established after the passing of this Act, the year ending with the thirty-first day of December, and, in the case of any Society established before the passing of this Act, the year ending with the time up to which its annual account and statement is made at the passing of this Act.

Auditors.

3. Notwithstanding anything in the rules of any Society under the Building Societies Acts, one at least of the Auditors of the Society shall be a person who publicly carries on the business of an accountant.

Inspection of Books.

4.—(1) The Registrar may, if he thinks fit, on the application of ten members of a Society under the Building Societies Acts, each of whom has been a member of the Society for not less than twelve months, immediately preceding the date of the application, appoint an accountant or actuary to inspect the books of the Society, and to report thereon.

(2) Provided as follows :—

(a) The applicants shall deposit with the Registrar such sum as a security for the costs of the proposed inspection as the Registrar may require ; and

(b) All expenses of and incidental to any such inspection shall be defrayed by the applicants, or out of the funds of the Society, or by the members or officers, or former members or officers, of the Society in such proportions as the Registrar may direct.

(3) A person appointed under this section shall have power to make copies of any books of the Society, and to take extracts therefrom at all reasonable hours, at the registered office of the Society, or at any place where the books are kept.

(4) The Registrar shall communicate the results of any such inspection to the applicants and to the Society.

Dissolution.

11.—If a Society under the Building Societies Acts is dissolved in manner prescribed by its rules or in pursuance of the consent of three-fourths of the members, the liquidators, trustees, or other persons having the conduct of the dissolution shall, within twenty-eight days from the termination of the dissolution, send to the Registrar an account and balance sheet signed and certified by them as correct, and showing the assets and liabilities of the Society at the commencement of the dissolution, and the mode in which those assets and liabilities have been applied and discharged ; and in default of so doing shall each be liable to a fine not exceeding five pounds for every day during which the default continues.

Prohibition of Advances under Second Mortgage.

13.—(1) A Society under the Building Societies Acts shall not advance money on the security of any freehold, copyhold, or leasehold estate which is subject to a prior mortgage, unless the prior mortgage is in favour of the Society making the advance.

(2) Provided that this section shall not apply to any Society in Scotland or Ireland, which is at the passing of this Act authorised by the rules to make advances upon second mortgage.

(3) If any advance is made in contravention of this section, the Directors of the Society who authorised the advance shall be jointly and severally liable for any loss, on the advance occasioned to the Society.

Limits of Borrowing Power.

14.—In calculating the amount for the time being secured to a Society under the Building Societies Acts, by mortgages from its members for the purpose of ascertaining the limits of its power to receive deposits or loans at interest, the amount secured on properties the payments in respect of which were upwards of twelve months in arrear at the date of the Society's last preceding annual account and statement, and the amount secured on properties of which the Society had been twelve months in possession at the date of such account and statement, shall be disregarded.

Deposits and Investments.

16.—(1) A Society under the Building Societies Acts may—

(a) Deposit in a Savings Bank any money belonging to the Society, provided that the whole amount, exclusive of Government stock, credited by the Bank to the Society, does not exceed three hundred pounds at any one time; and

(b) Invest in Government stock through a Savings Bank any money of the Society, provided that the whole amount of Government stock credited by the Bank to the Society, does not exceed five hundred pounds stock at any one time.

(2) In this section the expressions "Savings Bank" and "Government Stock" have respectively the same meaning as in the Savings Bank Act, 1893.

17. The powers of investment under Section twenty-five of the Building Societies Act, 1874, shall include power to invest in or upon any security in which Trustees are for the time being authorised by law to invest.

Illicit Gifts and Commissions.

23. No Director, Secretary, Surveyor, Solicitor, or other Officer of a Society under the Building Societies Acts shall, in addition to the remuneration prescribed or authorised by the rules of the Society, receive from any other person any gift, bonus, commission, or benefit, for or in connection with any loan made by the Society, and any person paying or accepting any such gift, bonus, commission, or benefit shall be liable on summary conviction to a fine not exceeding fifty pounds, and, in default of payment, to be imprisoned with or without hard labour for any time not exceeding six months, and the person accepting any such gift, bonus, commission, or benefit, shall, as and when directed by the Court by whom he is convicted, pay over to the Society the amount or value of such gift, bonus, commission, or benefit, and in default of such payment shall be liable to be imprisoned with or without hard labour for any time not exceeding six months.

2.—STATEMENT SHOWING THE OPERATIONS OF THE YEAR.

Balances at beginning of Year, as shown by last Annual Statement.	Additions during the Year (Stating under each head the total amounts added and not the excess of additions over diminutions)			Diminutions during the Year (Stating under each head the total diminution and not the excess of diminutions over additions)			Balances at end of Year, as shown by last Annual Statement.
	£	s	d	Particulars	Amount	Particulars	Am. unit
Due to Shareholders				Subscriptions of Shareholders		Withdrawals of Shareholders	
				Interest added		Interest paid	
				Other additions, viz —		Other diminutions, viz —	
Due to Depositors and other Creditors				New Deposits		Deposits withdrawn	
				Interest added		Interest paid	
				Other additions, viz —		Other diminutions, viz —	
Undivided Profit, not including Prospective Interest				Fines and Fees		Management expenses, viz —	
				Other sources of Profit, viz —			
Due on Mortgage Securities, not including Prospective Interest				Advanced on Mortgage		Redemption of Advances	
				Interest due on Borrowings		Interest received from Borrowers	
				Other additions, viz —		Inclusion in Profit and Loss Account	
						Amount written off for Losses, viz —	
Other Assets				Investments made, viz —		Investments realized, viz —	
Balance deficient (if any)				Interest on Investments		Interest received on Investments, viz —	
				Other additions, viz —		Other diminutions, viz —	
Total £				(B)			(D)
Total £				(C)			Total £

A and B added together must equal C and D added together

To undivided Profit (including Reserve Funds, but not including Reserve Profit), viz. —

On—Mortgages on Property of which the Society has been upwards of 12 months in possession, as shown by Part II. of the Schedule..			
On—Mortgages where the repayments are upwards of 12 months in arrear, and the Property has not been upwards of 12 months in possession of the Society, as shown by Part III. of the Schedule			
Total number of properties mortgaged to the Society.			
(d)			
Total			(a)
By other Assets :—			
Amount invested in the Funds (bearing interest at _____ per cent.)			
Amount invested in other securities, viz. :—			
Nature of Security.	Rate of Interest.		
Other Assets, viz. :—			
Cash at Bankers			
Cash in hands of			(c)
By Balance Deficient (if any) ..			(b)
(D)			(D)

(D), (e), (f), (g), (h), (i), (j). These figures must agree with those in the last column of Statement No. 2.

(i). This figure must agree with that in the Certificate of the Auditors.

PARTICULARS to be set forth in the case of every Mortgage when the Repayments are upwards of Twelve Months in Arrear, and the Property has not been upwards of Twelve Months in possession of the Society.

§ 8.—Friendly Societies.

(a) The Friendly Societies Act, 1896.

Appointment of Trustees.

25.—(1) Every registered Society and Branch shall have one or more Trustees.

(4) The same person shall not be a Secretary or Treasurer of a registered Society or Branch, and a Trustee of that Society or Branch.

Audit.

26.—(1) Every registered Society and Branch shall once at least in every year submit its accounts for audit either to one of the Public Auditors appointed as in this Act mentioned, or to two or more persons appointed as the rules of the Society or Branch provide.

(2) The Auditors shall have access to all the books and accounts of the Society or Branch, and shall examine the Annual Return mentioned in this Act, and verify the Annual Return with the accounts and vouchers relating thereto, and shall either sign the Annual Return as found by them to be correct, duly vouched, and in accordance with law, or specially report to the Society or Branch in what respects they find it incorrect, unvouched, or not in accordance with law.

Annual Return.

27.—(1) Every registered Society and Branch shall, once in every year, not later than the thirty-first day of May, send to the Registrar a return (in this Act called the Annual Return) of the receipts and expenditure, funds, and effects of the Society or Branch as audited.

(2) The Annual Return must—

(a) Show separately the expenditure in respect of the several objects of the Society or Branch; and

(b) Be made out to the thirty-first day of December then last inclusively; and

(c) State whether the audit has been conducted by a Public Auditor appointed as by this Act provided, and by whom, and, if by persons other than a Public Auditor, state the name, address, and calling or profession of every such person, and the manner in which, and the authority under which, he is appointed.

(3) The Society or Branch shall, together with the Annual Return, send a copy of any special report of the Auditors.

(4) In the case of a Branch the Annual Return shall be sent to the Registrar through an officer appointed in that behalf by the Society of which the Branch forms part.

Quinquennial Valuation.

28.—(1) Every registered Society and Branch shall, except as in this section provided, once at least in every five years either—

- (a) Cause its assets and liabilities to be valued by a valuer to be appointed by the Society or Branch and send to the Registrar a report on the condition of the Society or Branch ; or
- (b) Send to the Registrar a return of the benefits assured and contributions receivable from all the members of the Society or Branch, and of all its funds and effects, debts and credits, accompanied by such evidence in support thereof as the Chief Registrar prescribes.

Balance Sheet.

29. Every registered Society and Branch shall keep a copy of the last Annual Balance Sheet, and of the last Quinquennial Valuation, together with any special report of the Auditors, always hung up in a conspicuous place at the registered office of the Society or Branch.

Public Auditors and Valuers.

30.—(1) For the purpose of audits and valuations to be made under this Act the Treasury may appoint Public Auditors and Valuers, and may determine the rates of remuneration to be paid by Societies and Branches for the services of those Auditors and Valuers ; but the employment of those Auditors and Valuers shall not be compulsory.

(2) The Treasury may, out of money to be provided by Parliament, pay to the Public Auditors and Valuers such remuneration (if any) as the Treasury may allow.

Subscriptions to Hospitals.

37. A registered Society or Branch may subscribe out of its funds to any hospital, infirmary, charitable or provident institution, any annual or other sum which may be necessary to secure to members of the Society or Branch and their families the benefits of the hospital, infirmary, or other institution, according to its rules.

Rights of Members.

39. Every registered Society and Branch shall supply gratuitously to every member or person interested in its funds, on his application, either

- (a) a copy of the last Annual Return of the Society or Branch ; or
- (b) a Balance Sheet or other document duly audited containing the same particulars as to the receipts and expenditure, funds and effects, of the Society or Branch as are contained in the Annual Return.

40. A member or person having an interest in the funds of a registered Society or Branch may inspect the books at all reasonable hours at the registered office of the Society or Branch, or at any place where the books are kept, except that the member or person shall not, unless he is an officer of the Society or Branch, or is specially authorised by a resolution of the Society or Branch to do so, have the right to inspect the loan account of any other member without the written consent of that member.

Investment of Funds.

44.—(1) The Trustees of a registered Society or Branch may, with the consent of the committee or of a majority of the members present and entitled to vote in general meeting, invest the funds of the Society or Branch, or any part thereof, to any amount in any of the following ways :—

(a) In the Post Office Savings Bank, or in any Savings Bank certified under the Trustee Savings Banks Act, 1863 ; or

(b) In the public funds ; or

(c) With the National Debt Commissioners as in this Act provided ; or

(d) In the purchase of land, or in the erection or alteration of offices or other buildings thereon ; or

(e) Upon any other security expressly directed by the rules of the Society or Branch, not being personal security, except as in this Act authorised with respect to loans.

(2) The rules of a Society with Branches, and of any Branch thereof, may provide for the investment of funds of the Society or of that Branch by the Trustees of any Branch, or by the Trustees of the Society, and the consent required for any such investment shall be the consent of the committee, or of such majority as aforesaid of the Society or Branch by whom the funds are invested.

Loans to Members.

45.—(1) A registered Society and, subject to the rules of the Society, a registered Branch may advance to a member of at least one full year's standing any sum not exceeding one-half of the amount of an assurance on his life, on the written security of himself and two satisfactory sureties for repayment.

(2) The amount so advanced, with all interest thereon, may be deducted from the sum assured, without prejudice in the meantime to the operation of the security.

46. A registered Society may, out of any separate loan fund to be formed by contributions or deposits of its members, make loans to members on their personal security, with or without sureties, as may be provided by the rules, subject to the following restrictions :—

(a) a loan shall not at any time be made out of money contributed for the other purposes of the Society :

- (b) a member shall not be capable of holding any interest in the loan fund exceeding two hundred pounds :
- (c) a Society shall not make any loan to a member on personal security beyond the amount fixed by the rules, or make any loan which, together with any money owing by a member to the Society, exceeds fifty pounds ;
- (d) a Society shall not hold at any one time on deposit from its members any money beyond the amount fixed by the rules, and the amount so fixed shall not exceed two-thirds of the total sums owing to the Society by the members who have borrowed from the Loan Fund.

Holding of Land.

47.—(1) A registered Society or Branch may (if the rules thereof so provide) hold, purchase, or take on lease in the names of the Trustees of the Society or Branch any land, and may sell, exchange, mortgage, lease or build upon that land (with power to alter and pull down buildings and again rebuild), and a purchaser, assignee, mortgagee, or tenant shall not be bound to inquire as to the authority for any sale, exchange, mortgage, or lease by the Trustees, and the receipt of the Trustees shall be a discharge for all sums of money arising from or in connection with the sale, exchange, mortgage, or lease.

(2) A Branch of a registered Society need not for the purposes of this section be separately registered.

(3) Nothing in this section shall authorise a Benevolent Society to hold land exceeding one acre in extent.

Investments with National Debt Commissioners.

52.—(1) A registered Society or Branch may pay to the account of the National Debt Commissioners at the Bank of England or the Bank of Ireland, as the case may require, any sum of money not less than fifty pounds upon a declaration of the Trustees of the Society or Branch, or any two of them, that the money belongs exclusively to the Society or Branch.

(5) A Society or Branch so investing money with the Commissioners shall be entitled to a receipt entitling to interest at the following rates :—

To a Friendly Society or Branch legally established before the twenty-eighth of July one thousand eight hundred and twenty-eight, which had invested funds with the Commissioners before the twenty-third of July one thousand eight hundred and fifty-five, a rate of interest in respect of any assurance made before the fifteenth of August one thousand eight hundred and fifty of	} per centum } per diem.
- - - - -	

<p>To a Friendly Society or Branch legally established between the twenty-eighth of July one thousand eight hundred and twenty-eight and the fifteenth of August one thousand eight hundred and fifty, which had invested funds with the Commissioners before the twenty-third of July one thousand eight hundred and fifty five, a rate of interest in respect of any assurance made before the fifteenth of August one thousand eight hundred and fifty of - - -</p>	<p>Twopence halfpenny per centum per diem.</p>
<p>To a Friendly Society or Branch legally established before the twenty-eighth of June one thousand eight hundred and eighty-eight, which had invested funds with the Commissioners before the first day of January one thousand eight hundred and ninety-six, a rate of interest in respect of any assurance made on or before the said twenty-eighth day of June of - - -</p>	<p>Twopence per centum per diem.</p>
<p>To a Society or Branch in respect of any investment with the Commissioners, other than as hereinbefore in this section mentioned, a rate of interest of - - -</p>	<p>Two pounds fifteen shillings per centum per annum.</p>

(6) A Society or Branch withdrawing money so invested with the Commissioners shall not be entitled to make any further deposit without their consent.

Officers to Render Accounts.

55.—(1) Every Officer of a registered Society or Branch having receipt or charge of money shall, at such times as by the rules of the Society or Branch he should render account, or upon demand made, or notice in writing given or left at his last or usual place of residence, give in his Account as may be required by the Society or Branch, or by the Trustees or Committee thereof, to be examined and allowed or disallowed by them, and shall, on the like demand or notice, pay over all sums of money and deliver all property in his hands or custody to such person as the Society or Branch, or the Committee, or the Trustees, appoint.

(2) In case of any neglect or refusal to deliver the Account, or to pay over the sums of money, or to deliver the property in manner aforesaid, the Trustees or authorised Officers of the Society or Branch may sue upon the bond or security before-mentioned, or may apply to the County Court or to a Court of Summary Jurisdiction, and the order of either such Court shall be final and conclusive.

Penalties.

82. If any person wilfully makes, orders, or allows to be made, any entry, erasure in, or omission from a balance sheet of a registered

Society or Branch, or a return or document required to be sent, produced, or delivered for the purposes of this Act, with intent to falsify the same or to evade any of the provisions of this Act, he shall be liable to a fine not exceeding fifty pounds.

THE FIRST SCHEDULE.

MATTERS TO BE PROVIDED FOR BY THE RULES OF SOCIETIES REGISTERED UNDER THIS ACT.

1. The name and place of office of the Society.
2. The whole of the objects for which the Society is to be established the purposes for which the funds thereof shall be applicable, the terms of admission of members, the conditions under which any member may become entitled to any benefit assured thereby, and the fines and forfeitures to be imposed on any member, and the consequences of nonpayment of any subscription or fine.
3. The mode of holding meetings and right of voting, and the manner of making, altering, or rescinding rules.
4. The appointment and removal of a Committee of Management (by whatever name), of a Treasurer and other Officers, and of Trustees, and in the case of a Society with Branches, the composition and powers of the central body, and the conditions under which a Branch may secede from the Society.
5. The investment of the Funds, the keeping of the Accounts, and the Audit of the same once a year at least.
6. Annual Returns to the Registrar, of the Receipts, Funds, Effects, and Expenditure, and Numbers of Members, of the Society.
7. The Inspection of the Books of the Society by every person having an interest in the Funds of the Society.
8. The manner in which disputes shall be settled.
9. In case of dividing Societies, a provision for meeting all claims upon the Society existing at the time of division before any such division takes place.

And also in the case of Friendly and Cattle Insurance Societies :—

10. The keeping separate Accounts of all moneys received or paid on account of every particular fund or benefit assured for which a separate table of contributions payable shall have been adopted, and the keeping separate account of the expenses of Management, and of all Contributions on account thereof.

11. (Except as to Cattle Insurance Societies) a valuation once at least in every five years of the Assets and Liabilities of the Society, including the estimated risks and contributions.

(b) Form of Return prescribed under the Friendly Societies Act, 1896.

ANNUAL RETURN PRESCRIBED BY THE CHIEF REGISTRAR FOR A REGISTERED FRIENDLY SOCIETY.

Year ending 31st December, 19 .

[The Society's Balance Sheet cannot be accepted as a substitute for this Return.]

This Return is to be sent to the Registrar not later than the 31st of May.

A copy of the Auditor's Report, if any, should also be sent.

Name of Society

Date of commencement of Society 18 .

When first Enrolled, Certified, or Registered 18 .

Names and Addresses of Trustees (Residing at
(Residing at

Residing at

Name and Address of Treasurer Residing at

Amount of Security given by him £

Number of Benefit Members at the beginning of the year

Number of Benefit Members admitted during the year .

Together

Number of Benefit Members who died during the year . }

Number of Benefit Members who left from other causes . }

Total number of Benefit Members at the end of the year

Of whom

were under 16 years of Age.

between 16 and 20 years of Age

" 20 and 50 " "

" 50 and 65 " "

over 65 years of Age. The Benefits the

Members over 65 are entitled to are

Average amount of Funds per member [that is, the total

Funds on the 31st December, 19 , divided by the

total number of Benefit Members] £

The Audit for the year has been conducted by Mr.

Public

Auditor [or by

, who were appointed Auditors by

under the authority of Rule No.].

Registered Office of the Society*

in the county

of

Date

19 .

* State full postal address.

This portion is to be filled up whether Form A or Form B is adopted.

Form A.—FOR SOCIETIES WHOSE MEMBERS PAY ONLY ONE CONTRIBUTION FOR ALL BENEFITS.

* Income.

(A.) BENEFIT FUND.

	£	s.	d.	£	s.	d.
Contributions
Levies if any
Pluses (not appropriated to Management Fund)
Entrance Fees (not appropriated to Management Fund)
Interest on Investments of Benefit Fund
Other Receipts (a)
Total Income
Amount of Benefit Fund at the beginning of the year
Total
Amount of Benefit Fund at the end of the Year, as per Balance Sheet (C)
Total Expenditure
Cost of Medical Aid
Payments for other Benefits (if any) (f)
Other Payments (if any) (g)
Total Expenditure
Amount of Benefit Fund at the end of the Year, as per Balance Sheet (C)
Total

(If for more than one purpose, state on separate lines the amount raised for each.)
(a) Specify their nature.

(e) If any further reductions they should be stated separately.

(f) State separately the expenditure for each.

(g) Specify their nature.

(B.) MANAGEMENT FUND.*

* If the Society was registered before 23rd July, 1955, and has no separate Management Fund provided for in its Rules, state the fact.

Income.

	£	s.	d.	£	s.	d.
Donations of Honorary Members to this Fund
Contributions of Members for Management
Levies upon Members for Management
Insurance Fees
Fines appropriated to this Fund by the Society's Rules
Interest on Investments of Management Fund
Other Receipts (if any) (b)
Total Income
Amount of Management Fund at the beginning of the year
Total
Salaries
Rent
Printing, Stationery, and Postage
Other Payments (if any) (h)
Total Expenses of Management
Bad Debts and Losses (h)
Total Expenditure
Amount of Management Fund at the end of the Year, as per Balance Sheet (C)
Total

(b) Specify their nature.

(h) Specify their nature.

(C) BALANCE SHEET OF FUNDS AND EFFECTS

	£	s	d		Rate per cent of Interest yielded	£	s	d
(c) Specify their nature				Amount of Benefit Fund (as above)				(t) State amount and description of stock
(d) Specify them				Amount of Management Fund (as above)				
				Debts (if any) legally incurred by Trustees on behalf of the Society (e)				
				Cash due to Treasurer (if any)				
				Other Liabilities (d)				
					Investments—			
					1 In the Public Funds (t)			Savings Bank
					2 Li the Commissioners for the Reduction of the National Debt			
					3 Upon Government Securities in Great Britain or Ireland			
					4 Upon Real Securities in Great Britain or Ireland			
					5 In Land			
					6 On other securities (t)			(g) State them separately
				T t l				
					Cash in the Post Office Savings Bank			(f) State in whose hands
					Cash in Hand (f)			(m) Specify them
					Other Assets (if any) (m)			
				Total				

N.B.—Societies to which this Form applies need not fill up Form A.

FORM B.—FOR SOCIETIES WHOSE MEMBERS PAY MORE THAN ONE CONTRIBUTION FOR BENEFITS.

Income.		(D.) BENEFIT FUNDS.		Expenditure.	
£	s. d.	£	s. d.	£	s. d.
Where these contributions are not divided the lines may be bracketed together.		Entrance Fees (belonging to Benefit Funds)		Members on full weeks pay to Members on full weeks pay to Members on reduced pay (1st period lasting weeks) pay to Members on reduced pay (2nd period lasting weeks) (7)	
(1) Other benefits (if any) for which separate contributions are paid should be stated separately.		Total as shown above. £		(8) State separately the expenditure for each.	
(2) Specify their nature.		Total Income		(9) Specify their nature.	
		Amount of Benefit Funds at the beginning of the year		Total Expenditure ..	
		Total		Amount of Benefit Funds at the end of the Year, as per Balance Sheet (F)	
				Total	

Or.

(F.) BALANCE SHEET OF FUNDS AND EFFECTS.

Dr.

	£	s.	d.	£	s.	d.	Rate per cent. of Interest yielded.		(11) State amount and description of stock.	(12) State them separately.	(13) State in whose hands.	(14) Specify them.
•												
•												
Total Benefit Funds [as per Account (D)] divided as under:—												
(4) Where these funds are not divided the amount should be indicated together.												
Sickness Fund (£)...					Investments: Savings Bank				
Death Fund					1. In the Public Funds (11) ..				
Old Age Fund					2. In the Public Funds (11) ..				
Widow's and Orphans' Fund					3. With the Commissioners for the Reduction of the National Debt ..				
Lying-in Fund					4. Upon Government Securities in Great Britain and Ireland ..				
Accident Fund					5. Upon Real Securities in Great Britain or Ireland ..				
Travelling Benefit Fund					6 In Land ..				
Distress Relief Fund					7 On other Securities (12) ..				
Medical Aid Fund..					Cash in the Post Office Savings Bank ..				
Total Benefit Funds [as shown above] £					Cash in Hand (13) ..				
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Signature of Treasurer

Signature of Secretary

Residing at*

* Give Postal Address

The undersigned, having had access to all the Books and Accounts of the Society, and having examined the foregoing General Statement, and verified the same with the Accounts and Vouchers relating thereto, now sign the same as found to be correct, duly vouched, and in accordance with law.

Signature of 1st Auditor
[or of Public Auditor]

Signature of 2nd Auditor

Address

Calling or Profession

Address

Calling or Profession

Date

19

If the Accounts are not audited by a Public Auditor appointed under the *Friendly Societies Act*, two persons, at least, must be appointed as Auditors. If in any respect these Accounts are incorrect, unvouched, or not in accordance with law, the Auditors are not to sign as above, but are to make a Special Report to the Society, of which a copy is to be sent to the Registrar with this Statement.

(c) The Friendly Societies Act, 1908.*Investment of Funds.*

4.—In subsection (1) of section 44 of the principal Act (which relates to the manner in which the funds of registered Societies and Branches may be invested) the following paragraph shall be added after paragraph (e):—

“ or

- (f) in any investment in which Trustees are for the time being by law authorised to invest trust funds.”

(d) The Societies Borrowing Powers Act, 1898.*Borrowing Powers.*

1. A Society may by rule provide that it may receive deposits and borrow money at interest from its members, or from other persons, and upon the registry of such rule the same shall be valid.

2. The expression “ Society ” in this Act means a specially authorised Society registered, or seeking registration, under the Friendly Societies Act, 1896, having for its object the creation of funds to be lent out to the members of the Society, or for their benefit, and having in its rules provisions

- (a) that no part of its funds shall be divided by way of profit, bonus, dividend, or otherwise among its members;
- (b) that all money lent to members shall be applied to such purpose as the Society or its Committee of Management may approve.

(e) The Collecting Societies and Industrial Assurance Companies Act, 1896.*Application of Act.*

1. This Act shall apply to every such

- (a) Friendly Society or Branch, whether registered or unregistered (in this Act referred to as a Collecting Society); and
- (b) Person or body of persons, whether corporate or unincorporate, granting Assurances on any one life for a less sum than twenty pounds (in this Act referred to as an Industrial Assurance Company),

as receives contributions or premiums by means of collectors at a greater distance than ten miles from the registered office or principal place of business of the Society or Company, and, in the case of an

Industrial Assurance Company, at less periodical intervals than two months:

Provided that nothing in this Act shall, except as expressly provided thereby, apply to any assurance with an Industrial Assurance Company the premiums in respect of which are receivable at greater periodical intervals than two months.

Balance Sheets and Annual Returns.

6.—(1) A copy of every Balance Sheet of a Collecting Society shall, during the seven days next preceding the meeting at which the Balance Sheet is to be presented, be kept open by the Society for inspection at every office at which the business of the Society is carried on, and shall be delivered or sent by post to every member on demand.

(2) The annual returns required to be sent to the Registrar under the Friendly Societies Act, 1896, shall, in the case of a Collecting Society, be certified by some person not an officer of the Society (otherwise than an Auditor thereof) carrying on publicly the business of an Accountant, and if not so certified shall be deemed not to have been made.

Penalties.

15. If any person wilfully makes, orders, or allows to be made any entry, erasure in, or omission from a contribution or collecting book, with intent to falsify that book, or to evade any of the provisions of this Act, he shall be liable to a fine not exceeding fifty pounds, recoverable at the suit of the Chief or any Assistant Registrar, or of any person aggrieved

(f) Form of Annual Return required under the Collecting Societies and Industrial Assurance Companies Act, 1896.

ANNUAL RETURN PRESCRIBED BY THE CHIEF REGISTRAR FOR A REGISTERED COLLECTING SOCIETY.

Year ending 31st December, 19 .

This Return is to be sent to the Registrar not later than 31st May following. A copy of the Auditors' Report, if any, should also be sent.

Name of Society

Date of commencement of Society 18 .

When first Enrolled, Certified, or Registered 18 .

Names and addresses of {
Trustees {
Residing at
Residing at
Residing at

If the names are more than can be conveniently inserted here, they may be added (with the amount of security given) on a separate sheet.]

Name and address of {
Treasurer, and of any {
other Officer in re- {
ceipt or charge of {
money {
Residing at
Residing at

Amount of Security given by him or them £

Number of Benefit Members at the beginning of the year ..

Number of Benefit Members admitted during the year ..

Together

Number of Benefit Members who died during the year {

Number of Benefit Members who left from other causes {

Total number of Benefit Members at the end of the year ..

Average amount of Funds per Member [that is, the total Funds on 31st December, 19 , divided by the total number of Benefit Members] £

Number of Notices of forfeiture during the year ..

Number of cases of forfeiture of benefit after notice ..

Dates of the General Meetings held during the year ..

Number of transfers to the Society of which it has given notice to the Society from which the transfer was sought

Number of transfers from the Society of which it has received notice from the Society by which the transfer was sought

The Audit for the year has been conducted by Mr. , Public

Auditor [or by who were appointed Auditors by ,
under the Authority of Rule No.].

Registered Office of Society * in the County
of

Date 19 .

N.B.—The Society's Balance Sheet cannot be accepted as a substitute for this return, although, if made up to the 31st December, the items composing it may, if applicable, be inserted in the return.

* State full postal address.

RETURN OF THE

SOCIETY FOR THE YEAR ENDING 31st DECEMBER, 19 . GENERAL ACCOUNT.

Income.		£	s.	d.	Expenditure.		£	s.	d.
Contributions under Tables:—					(weeks pay to Members on full pay (lasting by rules weeks) weeks pay to Members on reduced pay (last period lasting weeks pay to Members on further reduced pay)				
For Sickness	..	..	..	..	Of Members and children of Members above 10 years of age:—	..	..	..	..
Death	..	..	..	..	Full sums assured . . . . .	..	..	..	..
Annuities	..	..	..	..	Grants of other diminished payments . . . . .	..	..	..	..
Endowments	..	..	..	..	Of full sums assured . . . . .	..	..	..	..
Medical Aid	..	..	..	..	Of full sums assured between 5 and 10 years of age . . . . .	..	..	..	..
Other Benefits (specify them) —	..	..	..	..	Of full sums assured . . . . .	..	..	..	..
Contributions for Management	..	..	..	..	Grants of other diminished payments . . . . .	..	..	..	..
Insurance Fees	..	..	..	..	Of full sums assured . . . . .	..	..	..	..
Donations of Honorary Members	..	..	..	..	Of full sums assured between 5 and 10 years of age . . . . .	..	..	..	..
Interest on Investments	..	..	..	..	Of full sums assured . . . . .	..	..	..	..
Amount received for copies of Rules at 1d each	..	..	..	..	Grants of other diminished payments . . . . .	..	..	..	..
Amount received for Policies at 1d. each	..	..	..	..	Of full sums assured . . . . .	..	..	..	..
Other Receipts (specify them) :—	..	..	..	..	Grants of other diminished payments . . . . .	..	..	..	..
	..	..	..	..	Annuities . . . . .	..	..	..	..
	..	..	..	..	Endowments . . . . .	..	..	..	..
	..	..	..	..	Grants of Medical Aid . . . . .	..	..	..	..
	..	..	..	..	Other payments (specify them) :—	..	..	..	..
Amount of Benefit Funds at beginning of Year	Total	..	..	..	Amount transferred to Management Fund	Total	..	..	..
	Total	..	..	..	Amount of Benefit Funds at end of Year, as per Balance Sheet	Total	..	..	..

Income.		£	s.	d.	Expenditure.		£	s.	d.
Amount transferred from General Account, as detailed below (A):					Salaries of Committee and Treasurer		..	..	..
per cent. on New Members' Contributions, £ s. d. . . . .	..	..	..	..	Salaries of Secretary, Clerks, and Servants	..	..	..	..
Under Table No. . . . .	..	..	..	..	Commission at per cent. and other remuneration of Agent and Collectors . . . . .	..	..	..	..
Under Table No. . . . .	..	..	..	..	Travelling Expenses . . . . .	..	..	..	..
Under Table No. . . . .	..	..	..	..	Law Charges . . . . .	..	..	..	..
Under Table No. . . . .	..	..	..	..	Legal Fees . . . . .	..	..	..	..
Per cent. on other Members' Contributions . . . . .	..	..	..	..	Remuneration of Auditors . . . . .	..	..	..	..
Under Table No. . . . .	..	..	..	..	Rent and Taxes . . . . .	..	..	..	..
Under Table No. . . . .	..	..	..	..	Printing . . . . .	..	..	..	..
Under Table No. . . . .	..	..	..	..	Stationery . . . . .	..	..	..	..
Under Table No. . . . .	..	..	..	..	Postage and Carriage of Parcels . . . . .	..	..	..	..
Entrance fees (under authority of Rule ) . . . . .	..	..	..	..	Other Payments (specify them) :—	..	..	..	..
Fines (under authority of Rule ) . . . . .	..	..	..	..		..	..	..	..
Donations of Honorary Members . . . . .	..	..	..	..		..	..	..	..
Interest on Management Fund . . . . .	..	..	..	..		..	..	..	..
Copies of Rules at 1d. each . . . . .	..	..	..	..		..	..	..	..
Policies at 1d. each . . . . .	..	..	..	..		..	..	..	..
Other Transfers (specify them) :—	..	..	..	..		..	..	..	..
Total as shown above (A)	Total	..	..	..	Bad Debts and Losses . . . . .	..	..	..	..
Amount of Management Fund at beginning of Year	Total	..	..	..		..	..	..	..
	Total	..	..	..	Amount of Management Fund at end of Year, as per Balance Sheet	Total	..	..	..

BALANCE SHEET OF FUNDS AND EFFECTS.

		£		s.		d.		Rate per cent. of Interest yielded.	
Liabilities.		£		s.		d.		Rate per cent. of Interest yielded.	
Amount of Sickness Fund									
Amount of Death Fund									
Amount of Annuity Fund									
Amount of Endowment Fund									
Amount of Medical Aid Fund									
Amount of other Funds (if any) (specify them) :—									
Total amount of Benefit Funds									
Amount of Management Fund									
Debts (if any) legally incurred by Trustees on behalf of the Society									
Cash due to Treasurer (if any)									
Other Liabilities (if any) (specify them) :—									
Total									
		£		s.		d.		Rate per cent. of Interest yielded.	
		£		s.		d.		Rate per cent. of Interest yielded.	
Assets.		£		s.		d.		Rate per cent. of Interest yielded.	
Investments :—		£		s.		d.		Rate per cent. of Interest yielded.	
1. In the Public Funds (specify them) :—		£		s.		d.		Rate per cent. of Interest yielded.	
2. In the National Debt (specify them) :—		£		s.		d.		Rate per cent. of Interest yielded.	
3. In the National Debt (specify them) :—		£		s.		d.		Rate per cent. of Interest yielded.	
4. Upon Government Securities in Great Britain or Ireland :—		£		s.		d.		Rate per cent. of Interest yielded.	
5. Upon Real Securities in Great Britain or Ireland :—		£		s.		d.		Rate per cent. of Interest yielded.	
6. In the purchase of land		£		s.		d.		Rate per cent. of Interest yielded.	
7. In the erection of offices and buildings		£		s.		d.		Rate per cent. of Interest yielded.	
8. In the erection of other buildings (specify them) :—		£		s.		d.		Rate per cent. of Interest yielded.	
Cash in the Post Office Savings Bank		£		s.		d.		Rate per cent. of Interest yielded.	
Cash in hand of		£		s.		d.		Rate per cent. of Interest yielded.	
Other Assets (if any) (specify them) :—		£		s.		d.		Rate per cent. of Interest yielded.	
Total		£		s.		d.		Rate per cent. of Interest yielded.	

Signature of Treasurer or one of the Trustees

Signature of Secretary

The undersigned, having had access to all the Books and Accounts of the Society, and having examined the foregoing General Statement [with additional sheet appended thereto], and verified the same with the Accounts and Vouchers relating thereto, now sign the same as found to be correct, duly vouched, and in accordance with law.

Signature of 1st Auditor

[or of Public Auditor]

Address

Calling or Profession

Signature of 2nd Auditor

Address

Calling or Profession

Date

If in any respect these Accounts are incorrect, unvouched, or not in accordance with law, the Auditors are not to sign as above, but are to make a special report to the Society, of which a copy is to be sent to the Registrar with this Statement.

If the Accounts are not audited by a Public Auditor, appointed under the Friendly Societies Act, two persons at least must be appointed as Auditors.

I certify that the particulars on this page, and on the three preceding pages [and in the sheet appended hereto] are correctly stated, and that I am not an Officer of the Society, otherwise than as Auditor, and carry on publicly the business of an Accountant at No.

Signature of Public Accountant

Date

(1) State postal address

(2) Give full address.

19

§ 9.—Industrial and Provident Societies.

(a) The Industrial and Provident Societies Act, 1893.

Audit.

13.—(1) Every registered Society shall once at least in every year submit its accounts for audit either to one of the Public Auditors appointed as in this Act mentioned, *or to two or more persons appointed as the rules of the Society provide.*

(2) The Auditors shall have access to all the books, deeds, documents, and accounts of the Society, and shall examine the Balance Sheets showing the receipts and expenditure, funds and effects of the Society, and verify the same with the books, deeds, documents, accounts, and vouchers relating thereto, and shall either sign the same as found by them to be correct, duly vouched, and in accordance with law, or specially report to the Society in what respects they find them incorrect, unvouched, or not in accordance with law.

Annual Returns.

14.—(1) Every registered Society shall once in every year, not later than the thirty-first day of March, send to the Registrar an annual return of the Receipts and Expenditure, Funds and effects of the Society as audited.

(2) The Annual Return

(a) shall be signed by the Auditor or Auditors ; and

(b) shall show separately the expenditure in respect of the several objects of the Society ; and

(c) *shall be made out from the date of its registration or last annual return to that of its last published Balance Sheet, provided that the last-named date is not more than one month before or after the thirty-first of December then last, or otherwise to the said day of December inclusive ; and*

(d) shall state whether the audit has been conducted by a Public Auditor appointed as by this Act is provided, and by whom, and, if by any persons other than a Public Auditor, shall state the name, address, and calling or profession of every such person, and the manner in which, and the authority under which, he is appointed.

The Society shall, together with the annual return, send a copy of the Report of the Auditors, or, if more than one such Report has been made during the period included in the Return, a copy of each of such Reports.

15. Every registered Society shall supply gratuitously to every member or person interested in the funds of the Society, on his application, a copy of the last annual return of the Society for the time being.

Note.—The above must be read in conjunction with the Industrial and Provident Societies Amendment Act, 1913.

Balance Sheet.

16. Every registered Society shall keep a copy of the last Balance Sheet for the time being, together with the Report of the Auditors, always hung up in a conspicuous place at the registered office of the Society.

Conditions of carrying on Banking Business.

19.—(1) No registered Society which has any withdrawable share capital shall carry on the business of banking.

(2) Every registered Society which carries on the business of banking shall on the first Mondays in February and August in each year make out and keep conspicuously hung up in its registered office, and every other office or place of business belonging to it where the business of banking is carried on, a statement in the form in the Third Schedule, or as near thereto as the circumstances admit.

(3) The taking deposits of not more than ten shillings in any one payment, nor more than twenty pounds for any one depositor, payable on not less than two clear days' notice, shall not be included in the business of banking within the meaning of this Act; but no Society which takes such deposits shall make any payment of withdrawable capital while any claim due on account of any such deposit is unsatisfied.

Holding of Land.

36. A registered Society may (if its rules do not direct otherwise) hold, purchase, or take on lease in its own name any land, and may sell, exchange, mortgage, lease, or build upon the same, or grant bonds and dispositions on security or other heritable securities over the same (with power to alter and pull down buildings and again rebuild).

Investments.

38.—(1) A registered Society may invest any part of its capital in or upon any security authorised by its rules, and also, if the rules do not direct otherwise--

- (a) in or upon any security in which Trustees are for the time being authorised by law to invest; and
- (b) in or upon any mortgage, bond, debenture, debenture stock, corporation stock, annuity, rentcharge, rent, or other security (not being securities payable to bearer) authorised by or under any Act of Parliament passed or to be passed of any Local Authority as defined by section thirty-four of the Local Loans Act, 1875; and
- (c) in the shares or on the security of any other Society registered or deemed to be registered under this Act, or under the Building Societies Acts, or of any Company registered under the Companies Acts or incorporated by Act of Parliament or by Charter, provided that no such investment be made in the shares of any Society or Company other than one with limited liability.

INDUSTRIAL AND PROVIDENT SOCIETIES ACT, 1893. 667

(2) A Society so investing shall be deemed to be a person within the meaning of the Companies Acts, and of the Building Societies Acts.

(3) Any investments made before the passing of this Act, which would have been valid if this Act had then been in force, are hereby ratified and confirmed.

39. A Society (not being one chargeable with income tax in pursuance of this Act) may invest its capital and funds, or any part thereof to any amount, in any Savings Bank certified under the Trustee Savings Banks Act, 1863, or in a Post Office Savings Bank.

Advances to Members.

40. The rules of a registered Society may provide for advances of money to members on the security of real or personal property, or in the case of a Society registered to carry on banking business in any manner customary in the conduct of such business.

Penalties.

65. If any person wilfully makes, orders, or allows to be made any entry or erasure in, or omission from, any Balance Sheet of a registered Society, or any contribution or collecting book, or any return or document required to be sent, produced, or delivered for the purposes of this Act, with intent to falsify the same, or to evade any of the provisions of this Act, he shall be liable to a fine not exceeding fifty pounds.

Public Auditors.

72. The Treasury may appoint Public Auditors for the purposes of this Act, and may determine the rates of remuneration to be paid by registered Societies for the services of such Auditors, but the employment of such Auditors shall not be compulsory.

SCHEDULE II.

MATTERS TO BE PROVIDED FOR BY THE RULES OF SOCIETIES
REGISTERED UNDER THIS ACT.

4. The appointment and removal of a Committee of Management, by whatever name, of Managers or other Officers, and their respective powers and remuneration.

6. Determination whether the Society may contract loans or receive money on deposit subject to the provisions of this Act from members or others; and, if so, under what conditions, on what security, and to what limits of amount.

8. Provision for the audit of accounts and for the appointment of Auditors or a Public Auditor.

9. Determination whether and how members may withdraw from the Society.

10. Mode of application of profits.

12. Determination whether, and by what authority, and in what manner, any part of the capital may be invested.

(b) The Industrial and Provident Societies Amendment Act, 1913.

Audit of Accounts

2. —(1) Every registered Society shall once in every year submit its accounts for audit to one or more of the Public Auditors appointed under the provisions of the principal Act.

(2) An Auditor shall not hold any other office in connection with the Society.

Annual Return.

3. (1) For paragraph (c) of sub-section (2) of section 14 of the principal Act (which relates to the date to which annual returns are to be made up) the following paragraph shall be substituted:—

(c) Shall be made up from the date of its registration or last annual return to that of its last published Balance Sheet, unless the last-mentioned date is more than four months before or more than one month after the thirty-first day of December, in which case it shall be made up to the said thirty-first day of December inclusive; and,

(2) A registered Society shall, together with the annual return, send to the Registrar a copy of the report of the Auditors, and a copy of each Balance Sheet made during the period included in the return.

Triennial Returns of Shareholders.

4.—A registered Society shall, once at least in every three years, make out and send to the Registrar, together with the annual return for the year, a special return, signed by the Auditor or Auditors, showing the holding of each person in the Society (whether in shares or loans) at the date to which the said annual return is made out: Provided that, where such persons are in the list of members kept by the Society distinguished by numbers, it shall be sufficient if they are distinguished in the special return by such numbers, and in that case it shall not be necessary to specify their names.

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(c) Form of Return prescribed under the Industrial and
• • • Provident Societies Act, 1893.ANNUAL RETURN PRESCRIBED BY THE CHIEF REGISTRAR
FOR SOCIETIES CARRYING ON INDUSTRIES AND TRADES
UNDER THE ABOVE ACT.

Year ending 31st December, 19 .

This Return is to be sent to the Registrar on or before the 31st of March,
19 .

A copy of the Auditors' Report, if any, is also to be sent.

Name of Society, Limited.

Industries carried on by Society (Productive)

Trades carried on by Society (Distributive)

Date of establishment 18 .

When first Registered 18 .

Name and Address of every Officer in receipt
or charge of money, and amount of
Security given by each }

Number of Members at the beginning of the Year

Number of Members admitted during the Year

Together

Number of Members whose membership has ceased during
the year

• Number of Members at the end of the year

Do the Rules of the Society allow of Credit being given ? If so,
state the number of the Rule.

Does the Society give Credit ? If so, to what limit ?

The Audit for the year has been conducted by Mr. , Public
Auditor [or by who were appointed Auditors by
under the authority of Rule No.]Registered office of Society* in the County of
Date 19 .PARTICULARS OF PRODUCTIVE OPERATIONS CARRIED ON BY
THE SOCIETY DURING THE YEAR.

Value of Productions for the year (Cost Price) £

Average Number of Workmen employed

Amount of Wages paid (exclusive of Bonus) £

Bonus to Labour £

DETAILS OF THE ABOVE PARTICULARS IN RESPECT OF THE VARIOUS
DEPARTMENTS OF THE SOCIETY :—

DEPARTMENT.	Value of Productions.	Average Number of Workmen employed.	Amount of Wages paid.	Bonus to Labour.	OBSERVATIONS.
[Place specify the Department.]	£		£	£	
Total as above					

* State full postal address.

Dr.

I CASH ACCOUNT

Cr.

RECEIPTS	£	s	d	PAYMENTS	£	s	d
Share Contributions				Share Capital Repaid			
Loans				Interest on Shares			
Deposits and Small Savings Department				Dividend to Members			
Sales of Goods				Non Members			
Rents				Loans			
Fees and Fines Entrance, Nomination Withdrawal				Deposits and Small Savings Department			
Rules and Pass or Contribution Books				Interest on Loans and Deposits and Bank Current Advances			
Interest and Profits on Investments				Goods including Carriage			
Dividend on Purchases				Expenses of Management —			
Educational Purposes				Salaries and Wages			
Investments—Deposit and Repayments of Advances on Security of Freehold or Leasehold Property				Rent Rates Taxes and Insurance			
Other Investments Realised or Advances repaid				Other Expenses			
Other Receipts (if any) (1)				For Land Buildings and Fixtures			
				For Trade Purposes			
				For other Purposes			
				Advances on Security of Freehold or Leaseholds			
				Other Advances or Investments			
				For Educational Purposes			
				Subscriptions to Charitable and other Objects			
				Other Payments (if any) (1) —			
Total Receipts				Total Payments			
Balance (if any) due to Bankers at end of Year				Balance (if any) due to Bankers at beginning of Year			
Balance of Cash in Hand and at Bank at beginning of Year				Balance of Cash in Hand and at Bank at end of Year as per Balance Sheet (III)			
Total	£			Total	£		
(1) To be specified				(1) To be specified			

II GENERAL ACCOUNTS—(A) TRADE OF YEAR.

INCOME	£	s	d	EXPENDITURE	£	s	d
Value of Stock in Trade at beginning of Year				Value of Stock in Trade at end of Year			
Purchases during Year, including Carriage				Sales of Goods during Year			
(2) Productive Expenses incurred in the Industries carried on by the Society				Dividend on Purchases			
(2) Distributive Expenses incurred in the Trades carried on by the Society							
Interest on Loans Deposits and Bank Current Advances							
Depreciation—Land, Buildings, and Fixtures							
Balance, Profit on Trade of Year, to Account B				Balance, Loss on Trade of Year to Account B			
Total ..	£			Total ..	£		

(2) These amounts should include Salaries and Wages and all other Productive or Distributive Expenses respectively, incurred during the Year.

Dr.	B.—PROFIT AND LOSS.			Cr	
£	s	d	£	s	d
Balance of Loss brought forward from last Year			Balance of Profit brought forward from last Year		
Loss on Trade of Year, from Account A			Profit on Trade of Year, from Account A		
Bad Debts			Interest and Profits on Investments		
Expenses not chargeable to Trade (specify them)			Fees and Limes Entrance Nomination Withdrawal		
			Other Credits (if any), specify them		
Balance disposable to Account C			Balance of Loss, as per Account III		
Total	£	—	Total	£	—

C.—APPLICATION OF PROFIT

£	s	d	£	s	d
Interest on Shares			Balance Disposable from Account I		
Dividends on Purchases — To Members Non Members					
Bonus to Employes					
Donations and Subscriptions					
Educational Purposes					
Reserve Fund					
Other Applications					
Profit carried to next Year as per Account III					
Total	£	—	Total	£	—

III — BALANCE SHEET OF FUNDS AND EFFECTS

£	s	d	£		
Due to Shareholders			Value of Stock in Trade (as in Account A)		
Due to Depositors and other Creditors			Building, Fixtures, and Land used in Trade		
			Investments and other Assets		
Investments and other Assets			In Buildings, Fixtures, and Land		
Deposits and Small Savings Department			On Freehold or Leasehold Security		
Bank Advances			On Loans or Deposits in Shares of Industrial and Provident Societies*		
Cash due to Treasurers			In other Shares () —		
Trade Debts			Other Investments ()		
Other Liabilities (1) —			Other Securities or Assets () —		
			Amount (if any) owing by Members at end of Year		
Profits appropriated but not yet paid, included in Account C			Cash in Bank		
			Hand ()		
			Total		
			Loss carried to next Year as per Account B		
Reserve Fund			Total Assets		
Profit carried to next Year, as per Account C			() State them separately		
			() State in whose hands		
Total					
Total Liabilities					
(1) To be specified					

(1) To be specified

Signature of Treasurer

Signature of Secretary

Residing at

The undersigned, having had access to all the Books and Accounts of the Society, and having examined the foregoing General Statement and verified the same with the Accounts and Vouchers relating thereto, now sign the same as found to be correct, duly vouched, and in accordance with law.

Signature of 1st Auditor
[or of Public Auditor]

Signature of 2nd Auditor

Address

Address

Calling or Profession

Calling or Profession

Date

19

If the Accounts are not audited by a Public Auditor, appointed under the Industrial and Provident Societies Act two persons, at least, must be appointed as Auditors.

If in any respect these Accounts are incorrect, unvouched, or not in accordance with law, the Auditors are not to sign as above, but are to make a Special Report to the Society, of which a copy is to be sent to the Registrar with this Statement.

§ 10.—Conditions under which Public Auditors hold their Appointments, and Scale of Fees.

Appointments and Scale of Fees.

1. Public Auditors are appointed to act in England and Wales, Scotland or Ireland. They will not, however, be ranked as public servants, and will have no salaries, nor any claim to pension or gratuity. Nor are they to assume the title of "Government Auditors" or any similar one; but are simply to describe themselves as "Public Auditors under the Friendly Societies Act, 1896, and the Industrial and Provident Societies Act, 1893." Public Auditors are not permitted to make any use of the Royal Arms.

2. The Public Auditor is bound to accept for audit (except as hereinafter mentioned) the account of any Society within that portion of the United Kingdom for which he is appointed, registered either under the Friendly Societies Act, or the Industrial and Provident Societies Act, which applies to him (the term "Society" to include a branch of a Society), for the fees hereinafter mentioned, the Society complying with the terms of these instructions. But no Public Auditor can audit the accounts, balance sheet, or annual return of any Society of which he is accountant, or any account, balance sheet, or annual return which he has himself prepared.

3. A Society desirous of submitting its accounts to a Public Auditor must forward all the necessary materials to his office or place of residence, in order to save travelling expenses or loss of time. It will be the duty of the Auditor, when applied to, to impress this upon the Society. He is not bound to leave his office for the purpose of the audit.

4. The Society must, at the same time, forward to the Auditor the annual return, or general statement of the receipts and expenditure, funds and effects of the Society, made up in the form for the time being required under the Friendly Societies Act, 1896, or the Industrial and Provident Societies Act, 1893, as the case may be.

5. The Auditor is to verify the annual return with the accounts and vouchers relating thereto, and either to sign the same as found by him to be correct, duly vouched, and in accordance with law, or specially to report to the Society in what respects he finds it incorrect, unvouched, or not in accordance with law.

6. The work of the Auditor will be strictly confined to auditing, but he has under the Acts a right of access to all the books and accounts of the Society. In the event of his discovering errors in the annual return, or the books, accounts, or vouchers submitted to him, they are to be returned (at the cost of the Society) for correction, unless the Auditor be requested by the Society to correct the inaccuracies in which case he is entitled to claim an additional fee, to be arranged between him and the Society.

7. The Auditor shall, in all cases, make a Report to the Society upon the accounts and other documents submitted to him, and, in case he has called for explanations or information from the Directors, or Committee of Management, he shall state whether such explanations or information have been given, and whether they have been satisfactory.

8. For auditing the accounts of Friendly Societies and specially authorised Societies granting Friendly Society benefits, the scale of payments shall be:—

	£	s.	d.
For Societies consisting of not more than 100 members ..	1	1	0
For Societies with over 100 members but not exceeding 500 members, in respect of each 100 members or part thereof	1	1	0
For Societies consisting of over 500 members, in respect of the first 500 members	5	5	0
With an additional 10s. 6d. in respect of each additional 100 members or part thereof, no fee, however, to exceed £52 10s., unless by special arrangement.			

For auditing the accounts of all other Societies registered under the Friendly Societies Acts, viz., Cattle Insurance Societies, Benevolent Societies, Working Men's Clubs, specially authorised Societies (except such as grant Friendly Society benefits), the scale of payment shall be:—

	£	s.	d.
For Societies whose total gross receipts do not exceed £2,000 per annum	1	1	0
For Societies whose total gross receipts exceed £2,000, but do not exceed £10,000 per annum, in respect of each £2,000 or fraction thereof	1	1	0
Where the gross receipts exceed £10,000 per annum, the fee to be fixed by private arrangement.			

9. For auditing the accounts of Industrial and Provident Societies, the scale of payment shall be:—

	£	s.	d.
For Societies whose total sales do not exceed £2,000 per annum	1	1	0
For Societies whose total sales exceed £2,000, but do not exceed £10,000 per annum, in respect of each £2,000 or fraction thereof	1	1	0
For Societies whose total sales exceed £10,000, but do not exceed £25,000 per annum, in respect of the first £10,000	5	5	0
With an additional 10s. 6d. in respect of each additional £2,000, or fraction thereof.			
Where the sales exceed £25,000 per annum, the fee to be fixed by special arrangement.			

The word "sales" in the case of Societies for the buying and selling of land, to include instalments in repayment of advances.

The scales of fees apply only in cases where the Society is located within the district assigned to the Auditor employed. If a Society employs an Auditor appointed for any other district, special terms may be arranged. The Auditor may accept audits on terms lower than those of the above scale.

10. Auditors shall hold their appointments from year to year, beginning on the first day of January in each year. The Treasury reserves to itself entire discretion as to re-appointing them.

11. They shall send in half-yearly to the Chief Registrar of Friendly Societies, a list containing the names of the Societies audited by them during the previous half-year, and the fees received from each Society, distinguishing Societies under the Friendly Societies Act from Societies under the Industrial and Provident Societies Acts. Neglect to do this will be held to disqualify for re appointment.

12. The scales of fees above laid down will only remain in force from year to year. At the end of any year they may be confirmed or altered in such manner as the Treasury may direct.

13. Auditors are requested to make themselves acquainted with the provisions of the Friendly Societies Act, 1896, and of the Industrial and Provident Societies Act, 1893, which affect the exercise of their functions. Their attention is particularly directed to Sections 26, 27, 84 and 88 of the Friendly Societies Act, 1896, and to Sections 13, 14, 62 and 65 of the Industrial and Provident Societies Act, 1893.

14. Apart from the above arrangement, the Auditors of the Local Government Board are authorised to exercise, subject to the sanction of that Board previously obtained, the functions of Public Auditors in their respective districts, but are not bound to accept any accounts for audit.

15. The Treasury reserves to itself the right of appointing additional Auditors if required.

16. The appointment of Public Auditor does not qualify the holder for undertaking valuation business, and it must not be used for obtaining such work.

A Public Auditor, not being also a Public Valuer, who desires to value Societies under the Friendly Societies Acts, must be either an Associate or Fellow of the Institute of Actuaries in England, or a Fellow of the Faculty of Actuaries in Scotland; and if a Public Auditor is found, after the issue of the present conditions, to have valued any such Society without being so qualified, he will be struck off the list of Public Auditors.

A Public Auditor qualified under these conditions to value Societies under the Friendly Societies Acts, must in every case strictly conform to instructions Nos. 5-13, both inclusive, of the instructions issued by the Treasury to Public Valuers appointed under the Act, and in making valuations for Societies shall not describe himself otherwise than as Associate or Fellow of the Institute of Actuaries, or as Fellow of the Faculty of Actuaries, as the case may be.

4. A Public Auditor who has been found to have solicited business, whether in the shape of audits or valuations, by offering commission or any other pecuniary inducement, either to officers or members of Societies, or to other persons, will be struck off the list of Public Auditors.

Note.—No valuation of the assets and liabilities of a Society or Branch shall be deemed to be a valuation under the Act when the person by whom the same is made (whether a Public Auditor qualified in accordance with condition 16, or any other person) has audited the accounts of the Society or Branch for the year next preceding the date at which the Society is valued.

§ 11.—Trustee Savings Banks.

(a) The Trustee Savings Banks Act, 1863.

Provisions to be contained in Rules.

6. No Savings Bank, subject to the proviso hereinafter contained with respect to the Branch Offices or Local Receivers of any Savings Bank, shall have the benefit of this Act, unless in the Rules and Regulations for the management thereof it shall be expressly provided—

- (1) That no person or persons, being Treasurer, Trustee, or Manager of such Savings Bank, or having any control in the management thereof, shall derive any benefit from any deposit made in such Savings Bank, save only and except such salaries and allowances or other necessary expenses as shall according to such rules and regulations be provided for the charges of managing such Savings Bank, and for remuneration to Officers employed in the management thereof, exclusive of the Treasurer or Treasurers, Trustee or Trustees, Manager or Managers, or other persons having direction in the management of such Savings Bank, who shall not directly or indirectly have any salary, allowance, profit, or benefit whatsoever therefrom beyond their actual expenses for the purposes of such Savings Bank.
- (2) That not less than two persons, being either Trustees, Managers, or paid Officers appointed for that specific purpose, and where two only, except in the case of Savings Banks which are open for more than six hours in every week, one such person to be a Trustee or Manager, be present on all occasions of public business, and be parties to every transaction of deposit and repayment, so as to form at least a double check on every such transaction with Depositors.
- (3) That the Depositor's pass book shall be compared with the ledger on every transaction of repayment, and on its first production at the Bank after each twentieth day of November.
- (4) That every Depositor in a Savings Bank established under this Act shall once at least in every year cause his deposit

book to be produced at the Office of the said Savings Bank for the purpose of being examined.

- (5) That no money be received from or paid to Depositors except at the Office or Branch Offices where the business of the Savings Bank is carried on under the authority of the Board of Managers and during the usual hours for public business.
- (6) That a Public Accountant or one or more Auditors be appointed by the Trustees and Managers, but not out of their own body, to examine the books of the Bank, and to report in writing to the Board or Committee of Management the result of such Audit, not less than once in every half year; also to examine an extracted list of the Depositors' balances made up every year to the twentieth day of *November*, and to certify as to the correct amount of the liabilities and assets of the Bank:
- (7) That a book containing such extracted list of every Depositor's balance, omitting the name, but giving the distinctive number and separate amount of each, and showing the aggregate number and amount of the whole, checked and certified by such Public Accountant or Auditors, be open at any time during the hours of public business for the inspection of every Depositor as respects his own account, to examine his own deposit book therewith, and the general results of the same:
- (8) That the Trustees and Managers, or Committee of Management, shall hold meetings once at least in every half-year, and shall keep minutes of their proceedings in a separate book provided for that purpose:
- (9) Provided that where Savings Banks are established with agents or local receivers elsewhere than at the Head Office, the rules shall provide for the due receipt of and accounting for all moneys by such agents or local receivers on account of such Savings Banks respectively, and also for the presence of a second party in every transaction when money is paid or received, and also for the periodical examination of the Depositors' books with the ledger once at the least in every year.

Weekly Returns.

7. The Trustees and Managers of every Savings Bank shall transmit weekly returns to the Commissioners for the Reduction of the National Debt, in such form and giving such particulars as the said Commissioners may direct, showing the amounts of the week's transactions of such Savings Bank, and the amount of the cash balances remaining in the hands of the Treasurer, or any other person on account of such Savings Bank.

Investments.

15. The several sums of money belonging to any Savings Bank which the Trustees of such Savings Bank respectively are authorised

to invest under this Act or under any rules or regulations of any such Savings Banks shall, except as hereinafter is excepted, be paid into and invested in the Bank of *England* or the Bank of *Ireland* as the case may require, in the names of the Commissioners for the Reduction of the National Debt, according to the provisions of this Act enabling such Trustees to make investments in the names of the said Commissioners, and no such sum or sums shall be paid or laid out by the Trustees of such Savings Bank in any other manner or upon any other security whatever, except as aforesaid, and except such sums of money as from time to time shall necessarily remain in the hands of the Treasurer or Treasurers of such Savings Bank to answer the exigencies thereof: Provided always, that nothing herein contained shall restrain or prevent any Depositor, or any Trustee or Trustees acting on behalf of any Depositor or Depositors of any Friendly Society, or any Charitable or Provident Institution or Society, or Penny Savings Bank, from withdrawing from any such Savings Bank any sum or sums of money which shall have been deposited by such Depositor, Friendly Society, Charitable or Provident Institution or Society, or Penny Savings Bank, and investing the same in any other securities: Provided always, that the Trustees of any Savings Bank already established, or which shall take the benefit of this Act in manner hereinbefore provided, shall be and they are hereby empowered to pay into the Bank of *England* or *Ireland* (as the case may be) any sum or sums of money, not being less than fifty pounds, to the account of the Commissioners for the Reduction of the National Debt, upon the declaration of the Trustees of such Savings Bank, or any two or more of them, that such moneys belong exclusively to the Savings Bank for which such payment is intended to be made, whether such moneys shall have been deposited therein before the passing of this Act or thereafter shall be deposited therein.

16. Nothing in this Act contained shall extend to prevent the Trustees of any Savings Bank already established or to be established receiving any sum or sums of money from any Depositor for any purpose except to be paid into the Bank to the account of the Commissioners for Reduction of the National Debt, and it shall be lawful for such Trustees to apply any such sum or sums of money in any other manner for the benefit of the several Depositors according to the rules and regulations of such Savings Banks respectively, anything in the said hereby repealed Acts or in this Act contained to the contrary notwithstanding.

17. In cases where any Savings Banks have been or shall be established in any town or place, and other smaller Banks have been or shall be established in the neighbourhood of such town or place as Branch Banks thereof, and such Branch Banks by their Treasurers have paid or shall pay any sums into the Bank in any such town or place as a Central Bank, it shall and may be lawful for the said Trustees of any such Central Bank, or any two of them, to pay into the Bank of *England* or *Ireland* in manner prescribed by this Act, along with the moneys belonging to such Central Bank, any sum or sums of money belonging to and on account of any such Branch Bank: Provided

always, that the Treasurer of such Branch Banks shall certify to the Treasurer of such Central Bank that the amount contributed by any one Depositor in any such Branch Bank in any one year does not exceed the limit of deposits authorised by this Act.

Interest due to Savings Banks.

22. All interest which shall become due and payable upon any sum of money mentioned in any such receipt upon the twentieth day of *November* and the twentieth day of *May* in every year next after the date of any such receipt shall be from time to time calculated and computed by the Officer of the said Commissioners, and shall in each and every year be placed to the credit of the Savings Bank on whose account any such sum of money was paid within six weeks from such twentieth day of *November* and twentieth day of *May* respectively, and shall be carried to and written on the account of such Savings Bank, and shall become principal, and shall from thenceforth carry interest as principal money paid into the said Bank of *England* or *Ireland*, as the case may be, on the account of such Savings Bank; and a receipt according to such form as the said Commissioners shall approve shall be signed by the Officers of the said Commissioners, and shall be issuable by the said Officer half-yearly within sixty days from and after such twentieth day of *November* and twentieth day of *May* respectively (and such receipts shall bear date the twenty-first day of *November* and twenty-first day of *May* respectively) for the amount of such interest so credited and made principal as aforesaid as if the amount thereof had been a payment made by the Trustees of such Savings Bank to the account of the said Commissioners: Provided always, that no interest shall be computed or calculated on any fractional part of a pound of the half yearly balance standing in the books of the said Commissioners on account of any Savings Bank on any twentieth day of *November* or twentieth day of *May* respectively.

Interest due to Depositors.

23. It shall be lawful for the Trustees and Managers of any such Savings Bank, if they shall so think fit, to direct that all interest which shall be payable to the Depositors in such Savings Bank shall yearly, or twice in each and every year, be calculated and computed by the Trustees of such Savings Bank, or such person or persons as they shall appoint, and shall be carried to the credit of such Depositors respectively, and shall become principal, and shall from thenceforth carry interest in all respects as other principal money deposited in the said Banks, or as if the said sum of interest so credited to the said Depositors respectively had actually been paid to the said Depositors and by them repaid to the said Trustees and Managers, any law, statute, or usage to the contrary notwithstanding: Provided always, that from and after the twentieth day of *November* one thousand eight hundred and sixty-three the interest payable to Depositors by the Trustees and Managers of any Savings Banks shall not exceed the rate of three pounds and tenpence *per centum per annum*.

Limits of Deposits.

39. It shall not be lawful for the Trustees of any Savings Bank to receive from any one present or future Depositor, within any one year ending on the twentieth day of *November* (whether any sum or sums of money had been previously withdrawn or not), any sum or sums exceeding in the whole thirty pounds, exclusive of compound interest: Provided always, that, except in the cases hereinafter provided, whenever the sum or sums standing in the name of any Depositor shall amount in the whole to two hundred pounds, principal and interest included, thenceforth no interest shall be payable on any such deposit so long as it shall continue to amount to the said sum of two hundred pounds

Appointment of Auditors in Ireland.

51. The Trustees of each Savings Bank in *Ireland* shall, as soon as conveniently may be after the passing of this Act, and from time to time in case of a vacancy, appoint an Auditor or Auditors to audit the accounts of the said Savings Bank, as well as to examine and inspect the books of the several Depositors, and the said Trustees shall immediately after such appointment transmit the signature, name, and address of the said Auditor or Auditors to the Commissioners for the Reduction of the National Debt; and the Trustees of every such Savings Bank in *Ireland* shall cause the Annual and other Statements required to be transmitted under this Act to be certified and verified by the Auditor or Auditors appointed by the said Trustees, in addition to the attestation by Trustees and Managers, as also required by this Act, and shall also cause a certificate from the said Auditor or Auditors, as to the result of his or their examination of such of the Depositors' books as may have been produced to him or them for examination to be transmitted with the said Annual Statement to the said Commissioners: Provided always, that it shall be lawful for the Trustees of any such Savings Bank in *Ireland* to agree with the Trustees of any other such Savings Bank or Banks in *Ireland* as to the appointment of a common Auditor or Auditors, and the Auditor or Auditors so appointed for all the said Banks shall be deemed and taken, as soon as the signature, name, and address shall have been transmitted by each such Bank to the said Commissioners, to be the Auditor or Auditors of each such Bank.

53. The rules of every Savings Bank in *Ireland* shall specify a number of days, not less than two in every year, ending on the twentieth of *November*, in which the book of each Depositor shall be produced at the office of the said Savings Bank for the purpose of being inspected, examined, and verified with the books of the Savings Bank by the Auditor or Auditors.

Annual Statements.

55. For the more effectual ascertaining from time to time the actual and progressive state of the several Savings Banks enrolled under the provisions of this Act, the Trustees and Managers of every such Savings Bank shall annually cause a general Statement of the

funds of such Savings Bank invested in the Bank of *England* or the Bank of *Ireland* in the names of the Commissioners for the Reduction of the National Debt to be prepared up to the twentieth day of *November* in each year showing the balance or principal sum due to all the Depositors collectively in such Savings Bank, and a Statement of the expenses incurred and stating in whose hands such balance shall then be remaining and every such Annual Statement shall be attested by two Managers or two Trustees or by one Manager and one Trustee, of such Savings Bank and every such Annual Statement shall be countersigned by the Secretary or Actuary of such Savings Bank, and all such Annual Statements shall be transmitted to the office of the said Commissioners for the Reduction of the National Debt in *London* or *Dublin* (as the case may be) within nine weeks after the twentieth day of *November* in each year.

59 The Trustees and Managers of every such Savings Bank shall cause a duplicate of every such Annual Statement accompanied by a list of the Trustees and Managers of such institution for the time being, attested and countersigned as aforesaid to be publicly affixed and exhibited in some conspicuous part of the office or place where the deposits of such Savings Bank are usually received, for the information of all parties making deposits therein and every such duplicate shall from time to time remain so affixed and exhibited until the ensuing Annual Statement shall in like manner be affixed and exhibited as aforesaid and every Depositor shall be entitled to receive from the said Savings Bank a printed copy of such Annual Statement on payment of one penny.

Calculation of Interest

62 For the purpose of rendering the Accounts of the several Savings Banks in *Great Britain* and *Ireland* uniform and correspondent with the Accounts of the Commissioners for the Reduction of the National Debt the interest payable to the Depositors in such Savings Banks in *Great Britain* and *Ireland* shall from and after the twentieth day of *November*, one thousand eight hundred and sixty three be computed half yearly to the twentieth day of *May* and the twentieth day of *November*, or yearly to the twentieth day of *November* in each year, as the case may be and to no other periods.

(b) The Savings Banks Act, 1891.

Inspection Committee

2 —(1) There shall be established an Inspection Committee of Trustee Savings Banks.

3 —(1) The Inspection Committee may appoint persons to inspect the books and accounts of Trustee Savings Banks, and to examine and ascertain and report to the Committee from time to time, with respect to each Bank, whether the Bank has complied with the requirements of the Acts and rules relating to the Bank as to the security to be taken from officers, the Accounts of the Bank, and

the conduct of its business, and whether any portion of the expenditure is excessive or unnecessary : and every Trustee Savings Bank shall give all due facilities for enabling any such inspection or examination to be made.

(4) The Trustees of every Trustee Savings Bank shall, on the requisition of the Committee, supply the Committee with a copy of the pass book in use in the Bank, of the Annual General Statement of the Accounts of the Bank, and of the rules of the Bank, and of any amendments thereof.

(5) If in the opinion of the Committee the rules of any such Bank are insufficient for the purpose of maintaining an efficient audit, the Bank shall with all convenient speed make such additional rules as may, in the opinion of the Committee, be required for the purpose.

(6) If the Bank do not, within a time specified by the Committee from the date of being required to make any such rules, comply with the requirement, the Committee may make such rules, and shall submit the rules so made to the Registrar of Friendly Societies, to be certified by him ; and, when so certified, they shall be binding on the Trustees.

Annual Statement.

8. The Annual Statement required by Section fifty-five of the Trustee Savings Banks Act, 1863, to be made by the Trustees and Managers of every Trustee Savings Bank shall be in such form, and contain, or be accompanied by, such particulars as the National Debt Commissioners direct. A similar Statement shall be sent to the Inspection Committee each year at the same time.

Special Investments.

10. The power of a Trustee Savings Bank to make investments (hereinafter referred to as special investments) in pursuance of Section sixteen of the Trustee Savings Banks Act, 1863, shall be subject to the following restrictions, namely :

- (a) An investment shall not be made after the commencement of this Act on behalf of any person unless he is at the time of making the investment a Depositor in the Bank to the extent of not less than fifty pounds : Provided that nothing in this subsection shall prevent the continuance of special investments in behalf of any person who is before the passing of this Act a Depositor under Section sixteen of the Trustee Savings Banks Act, 1863 ;
- (b) The total amount to be invested after the commencement of this Act on behalf of any one Depositor shall not exceed five hundred pounds in the aggregate ;
- (c) The money received for investment after the commencement of this Act shall not be invested in any manner not for the time being authorised by law in the case of investment by Trustees, and shall not be invested on mortgage of land or any interest in land ;

- (d) The Accounts of the Bank shall be kept so as to distinguish between the receipts and expenditure on account of special investments and the receipts and expenditure on account of the general business of the Bank.
- (e) The assets of the Bank in respect of ordinary deposits shall not be chargeable with any part of the expenditure on account of special investments, and shall not be liable for any loss or deficiency in respect of special investments.
- (g) The Annual Statement required by Section fifty five of the Trustee Savings Banks Act, 1963, shall contain, or be accompanied by, such particulars with respect to the special investments of the Bank as the National Debt Commissioners direct.
- (h) The Rules of the Bank shall provide to the satisfaction of the Inspection Committee for the audit examination and publication of the investment accounts, for the safe custody of the securities held by the Bank on account of special investments, and the security to be given by Officers of the Bank in respect of the amount received on such account.
- (i) The power to make special investments shall not be exercised by any Bank unless the Bank has exercised the power before the first day of June, one thousand eight hundred and ninety one.

Limits of Deposit and Interest

11. Whereas it is not lawful for the Trustees of a Savings Bank or for the Postmaster General to receive from any Depositor any sum which shall make the sum to which such Depositor shall be entitled exceed the sum of one hundred and fifty pounds in the whole, exclusive of interest, but the sum standing in the name of any Depositor may be increased by accumulation of interest to any sum not exceeding two hundred pounds in the whole and difficulties have arisen in the due apportionment between principal and interest standing to the credit of Depositors in excess of one hundred and fifty pounds, be it therefore enacted as follows

- (1) A Savings Bank shall not receive any deposit which makes the sum standing in the name of any Depositor in the Bank exceed two hundred pounds.
- (2) So much of any enactment as prohibits the receipt from any Depositor of any sum of money which makes the sum to which he is entitled exceed the sum of one hundred and fifty pounds in the whole, exclusive of interest, is hereby repealed.
- (3) Interest shall be allowed in full on the sum standing in the name of a Depositor in a Savings Bank so long as it does not exceed two hundred pounds, but whenever the sum standing in the name of any Depositor in any Savings Bank exceeds that amount, interest shall not be allowed on any sum in excess of two hundred pounds.

- (4) Notwithstanding any restriction on the amount to be deposited in any one year, a Depositor in a Savings Bank may, not more than once in any Savings Bank year, deposit money to replace money previously withdrawn in one entire sum during that year. For the purposes of this provision the expression "Savings Bank year" means, with reference to Trustee Savings Banks, the year ending the twentieth day of November, and with reference to the Post Office Savings Banks, the year ending the thirty first day of December.

§ 12. —Executors and Trustees.

(a) The Public Trustee Act, 1906.

Establishment of Public Trustee.

1. -(1) There shall be established the office of Public Trustee.
 (2) The Public Trustee shall be a corporation sole under that name, with perpetual succession and an official seal, and may sue and be sued under the above name like any other corporation sole, but any instruments sealed by him shall not, by reason of his using a seal, be rendered liable to a higher stamp duty than if he were an individual.

Powers and Duties of Public Trustee.

2. -(1) Subject to and in accordance with the provisions of this Act and rules made thereunder, the Public Trustee may, if he thinks fit—

- (a) act in the administration of estates of small value ;
- (b) act as custodian Trustee ;
- (c) act as an ordinary Trustee .
- (d) be appointed to be a judicial Trustee ;
- (e) be appointed to be the administrator of the property of a convict under the Forfeiture Act, 1870.

(2) Subject to the provisions of this Act, and to the rules made thereunder, the Public Trustee may act either alone or jointly with any person or body of persons in any capacity to which he may be appointed in pursuance of this Act, and shall have all the same powers, duties, and liabilities, and be entitled to the same rights and immunities, and be subject to the control and orders of the Court, as a private Trustee acting in the same capacity.

(3) The Public Trustee may decline, either absolutely or except on the prescribed conditions, to accept any trust, but he shall not decline to accept any trust on the grounds only of the small value of the trust property.

(4) The Public Trustee shall not accept any trust which involves the management or carrying on of any business, except in the cases in which he may be authorised to do so by rules made under this Act,

nor any trust under a deed of arrangement for the benefit of creditors, nor the administration of any estate known or believed by him to be insolvent.

(5) The Public Trustee shall not accept any trust exclusively for religious or charitable purposes, and nothing in this Act contained, or in the rules to be made under the powers of this Act, contained shall abridge or affect the powers or duties of the Official Trustee of charity lands or Official Trustees of charitable funds.

As Custodian Trustee

4 - (1) Subject to rules under this Act, the Public Trustee may, if he consents to act as such, and whether or not the number of trustees has been reduced below the original number, be appointed to be custodian trustee of any trust -

- (a) by order of the Court made on the application of any person on whose application the Court may order the appointment of a new trustee, or
- (b) by the testator, settlor, or other creator of any trust, or
- (c) by the person having power to appoint new trustees.

(2) Where the Public Trustee is appointed to be custodian trustee of any trust

- (a) The trust property shall be transferred to the custodian trustee as if he were sole trustee, and for that purpose vesting orders may, where necessary, be made under the Trustee Act, 1893:
- (b) The management of the trust property and the exercise of any power or discretion exercisable by the trustees under the trust shall remain vested in the trustees other than the custodian trustee (which trustees are hereinafter referred to as the managing trustees):
- (c) As between the custodian trustee and the managing trustees, and subject and without prejudice to the rights of any other persons, the custodian trustee shall have the custody of all securities and documents of title relating to the trust property, but the managing trustees shall have free access thereto and be entitled to take copies thereof or extracts therefrom:
- (d) The custodian trustee shall concur in and perform all acts necessary to enable the managing trustees to exercise their powers of management or any other power or discretion vested in them (including the power to pay money or securities into Court), unless the matter in which he is requested to concur is a breach of trust, or involves a personal liability upon him in respect of calls or otherwise, but, unless he so concurs, the custodian trustee shall not be liable for any act or default on the part of the managing trustees or any of them:
- (e) All sums payable to or out of the income or capital of the trust property shall be paid to or by the custodian trustee: Provided that the custodian trustee may allow the dividends

- • • and other income derived from the trust property to be paid to the managing trustees or to such person as they direct, or into such bank to the credit of such person as they may direct, and in such case shall be exonerated from seeing to the application thereof, and shall not be answerable for any loss or misapplication thereof.

(3) The provisions of this section shall apply in like manner as to the Public Trustee to any banking or insurance company or other body corporate entitled by rules made under this Act to act as custodian trustee, with power for such company or body corporate to charge and retain or pay out of the trust property fees not exceeding the fees chargeable by the Public Trustee as custodian trustee.

As an Ordinary Trustee.

5.—(1) The Public Trustee may by that name, or any other sufficient description, be appointed to be trustee of any will or settlement or other instrument creating a trust, or to perform any trust or duty belonging to a class which he is authorised by the rules made under this Act to accept, and may be so appointed whether the will or settlement or instrument creating the trust or duty was made or came into operation before or after the passing of this Act, and either as an original or as a new trustee, or as an additional trustee, in the same cases, and in the same manner, and by the same persons or Court, as if he were a private trustee, with this addition, that, though the trustees originally appointed were two or more, the Public Trustee may be appointed sole trustee.

Mode of Action of Public Trustee.

11.—(2) The Public Trustee may, subject to the rules made under this Act, employ for the purposes of any trust such solicitors, bankers, accountants, and brokers, or other persons as he may consider necessary, and in determining the persons to be so employed in relation to any trust the Public Trustee shall have regard to the interests of the trust, but subject to this shall, whenever practicable, take into consideration the wishes of the creator of the trust and of the other trustees (if any), and of the beneficiaries, either expressed or as implied by the practice of the creator of the trust, or in the previous management of the trust.

(5) The entry of the Public Trustee by that name in the books of a company shall not constitute notice of a trust, and a company shall not be entitled to object to enter the name of the Public Trustee on its books by reason only that the Public Trustee is a corporation, and, in dealings with property, the fact that the person or one of the persons dealt with is the Public Trustee shall not of itself constitute notice of a trust.

Investigation and Audit of Trust Accounts.

13.—(1) Subject to rules under this Act, and unless the Court otherwise orders, the condition and accounts of any trust shall, on an

application being made and notice thereof given in the prescribed manner by any trustee or beneficiary, be investigated and audited by such solicitor or public accountant as may be agreed on by the applicant and the trustees, or, in default of agreement, by the Public Trustee or some person appointed by him.

Provided that (except with the leave of the Court) such an investigation or audit shall not be required within twelve months after any such previous investigation or audit, and that a trustee or beneficiary shall not be appointed under this section to make an investigation or audit.

(2) The person making the investigation or audit (hereinafter called the auditor) shall have a right of access to the books, accounts, and vouchers of the trustees, and to any securities and documents of title held by them on account of the trust, and may require from them such information and explanation as may be necessary for the performance of his duties, and upon the completion of the investigation and audit shall forward to the applicant and to every trustee a copy of the accounts, together with a report thereon, and a certificate signed by him to the effect that the accounts exhibit a true view of the state of the affairs of the trust, and that he has had the securities of the trust fund investments produced to and verified by him, or (as the case may be) that such accounts are deficient in such respects as may be specified in such certificate.

(3) Every beneficiary under the trust shall, subject to rules under this Act, be entitled at all reasonable times to inspect and take copies of the accounts, report, and certificate, and, at his own expense, to be furnished with copies thereof or extracts therefrom.

(4) The auditor may be removed by order of the Court, and, if any auditor is removed, or resigns, or dies, or becomes bankrupt; or incapable of acting before the investigation and audit is completed, a new auditor may be appointed in his place in like manner as the original auditor.

(5) The remuneration of the auditor and the other expenses of the investigation and audit shall be such as may be prescribed by rules under this Act, and shall, unless the Public Trustee otherwise directs, be borne by the estate; and, in the event of the Public Trustee so directing, he may order that such expenses be borne by the applicant or by the trustees personally, or partly by them and partly by the applicant.

(6) If any person having the custody of any documents to which the auditor has a right of access under this section fails or refuses to allow him to have access thereto, or in anywise obstructs the investigation or audit, the auditor may apply to the Court, and thereupon the Court shall make such order as it thinks just.

(7) Subject to rules of Court, applications under or for the purposes of this section to the High Court shall be made to a Judge of the Chancery Division in Chambers.

• (6) If any person in any statement of accounts, report, or certificate required for the purposes of this section wilfully makes a statement false in any material particular, he shall be liable on conviction on indictment to imprisonment for a term not exceeding two years, and on summary conviction to imprisonment for a term not exceeding six months, with or without hard labour, and in either case to a fine in lieu of or in addition to such imprisonment.

(b) The Public Trustee Rules, 1912.

Investigation and Audit of Trust Accounts.

31. Any application under section 13 (1) of the Act shall be made to the Public Trustee, and notice thereof shall (unless the Public Trustee otherwise directs) be given by the applicant to every other person being a trustee or beneficiary under the trust.

32. -(1) Upon receiving any such application the Public Trustee may in his absolute discretion by notice to the applicant require that before a day to be specified in the notice such security (by deposit of a sum of money) as he shall deem sufficient shall be given to him by the applicant for the payment of any expenses of the investigation and audit which may be ordered by the Public Trustee to be paid by the applicant personally

(2) Where any such requirement is made no further proceedings shall be taken upon the application until the security has been given, and if the same is not given before the day specified in the notice the application shall be disallowed unless under special circumstances the Public Trustee thinks fit to extend the time for giving the security or to dispense therewith.

(3) Any sum so deposited shall be kept by the Public Trustee on deposit in his name and to a separate account at a Bank until all proceedings in connection with the investigation and audit have been concluded, and thereupon the deposited sum and the interest (if any) allowed thereon by the Bank shall be applied in or towards payment of any expenses of the investigation and audit which may be so ordered to be paid by the applicant personally and the balance (if any) shall be paid to the applicant.

33. The Public Trustee may in his absolute discretion upon the application of any trustee or beneficiary direct that the investigation and audit shall extend only to a specified period of time or to a specified part of the trust property or shall be otherwise restricted.

34. If within one month from the date of the application under section 13 (1) of the Act no Solicitor or public accountant shall have been appointed by the applicant and the trustees to conduct the investigation and audit, there shall be deemed to be a default of agreement within the meaning of the said section 13 (1) and the applicant may apply to the Public Trustee accordingly.

35. The remuneration of the auditor and the other expenses of the investigation and audit shall be such as may be determined by the

Public Trustee. Provided that the Public Trustee may refer the costs of any Solicitor (being part of such expenses) for taxation to a Taxing Master of the Supreme Court, and in such case the amount of the said costs when taxed shall be included in such expenses.

36.—(1) Where any investigation or audit has been made, copies of the report and certificate of the auditor under section 13 (2) of the Act and such copies of accounts and other documents as the Public Trustee may require shall be forwarded to him by the auditor, and shall be considered by the Public Trustee before giving any direction or making any order under section 13 (5) of the Act.

(2) The expense of making and forwarding any such copies as aforesaid and the fee of the Public Trustee (within the limits prescribed by or in pursuance of any order relating to the fees of the Public Trustee for the time being in force) shall for the purpose of section 13 (5) of the Act be part of the expenses of the investigation and audit.

37.—(1) Before making any order under section 13 (5) of the Act the Public Trustee shall, if any of the parties interested so desire, hear the said parties in such manner as he shall think fit.

(2) Any such order shall specify the person by or to whom any sum is to be paid and the amount of such sum. Provided that such an order may direct payment of the taxed costs of any solicitor employed in connection with the investigation and audit, and such costs shall be taxed by a Taxing Master of the Supreme Court, and the amount of such costs when taxed shall be paid as if such amount had been specified in the Order.

(3) Any such Order may be enforced in the same manner as a judgment or order of the Court to the same effect.

45. The Public Trustee Rules, 1907, are hereby rescinded.

(c) The Judicial Trustees Act, 1896.

Appointment of Judicial Trustee.

1.—(1) Where application is made to the Court by or on behalf of the person creating or intending to create a trust, or by or on behalf of a trustee or beneficiary, the Court may, in its discretion, appoint a person (in this Act called a judicial trustee) to be a trustee of that trust, either jointly with any other person or as sole trustee, and, if sufficient cause is shown, in place of all or any existing trustees.

(4) The Court may, either on request or without request, give to a judicial trustee any general or special directions in regard to the trust or the administration thereof.

(5) There may be paid to a judicial trustee out of the trust property such remuneration, not exceeding the prescribed limits, as the Court may assign in each case, subject to any rules under this Act respecting the application of such remuneration where the judicial trustee is an official of the Court, and the remuneration so assigned to any judicial trustee shall, save as the Court may for special reasons otherwise order, cover all his work and personal outlay.

• (6) Once in every year the accounts of every trust, of which a judicial trustee has been appointed, shall be audited, and a report thereon made to the Court by the prescribed persons, and, in any case, where the Court shall so direct, an inquiry into the administration by a judicial trustee of any trust, or into any dealing or transaction of a judicial trustee, shall be made in the prescribed manner

(d) The Judicial Trustees Rules, 1897.

Guarantee Premiums

9.—9) Any premium payable by a judicial trustee to any guarantee company on account of its security may, if the Court so directs, be paid out of the trust property

Banking Account

10.—(1) When a judicial trustee is appointed, a separate account for receipts and payments on behalf of the trust must be kept in the names of the trustees at some bank approved by the Court

(2) All title deeds and all certificates and other documents which are evidence of the title of the trustee to any of the trust property shall be deposited either with that bank or in such other custody as the Court directs

11: A judicial trustee must pay all money coming into his hands on account of his trust without delay to the trust account at the bank, and if he keeps any such money in his hands for a longer time than the Court considers necessary, shall be liable to pay interest upon it at such rate not exceeding five per centum as the Court may fix for the time during which the money remains in his hands

Accounts and Audit

14.—(1) The Court shall give directions to a judicial trustee as to the date to which the accounts of the trust are to be made up in each year, and shall fix in each year the time after the date within which the accounts are to be delivered to it for audit

(2) The accounts shall in ordinary cases be audited by the officer of the Court, but the Court, if it considers that the accounts are likely to involve questions of difficulty, may refer them to a professional accountant for report, and order the payment to him of such amount in respect of his report as the Court may fix

15.—(1) The accounts of any trust of which there is a judicial trustee, with a note of any corrections made upon the audit, shall be filed as the Court directs

(2) The judicial trustee shall send a copy of the accounts, or, if the Court thinks fit, of a summary of the accounts, of the trust to such beneficiaries or other persons as the Court thinks proper.

(3) The Court may, if it thinks fit, having regard to the nature of the relation of the applicant to the trust, allow any person applying

to inspect the filed accounts so to inspect them on giving reasonable notice to the officer of the Court

- 16. A judicial trustee shall, unless the Court otherwise directs, be allowed on the audit of his accounts deductions made on account of his remuneration and allowances under these rules, and also on account of the fees paid by him under these rules, but shall not be allowed any deduction on account of the expenses of professional assistance, or his own work or personal outlay, unless the deduction has been authorised by the Court in pursuance of the Act, or the Court is satisfied that the deduction is justified by the strict necessity of the case

Remuneration of Trustee

17.—(1) Where a judicial trustee is to be remunerated, the remuneration to be paid to him shall be fixed by the Court, and may be altered by the Court from time to time

(2) In fixing the remuneration, regard shall be had to the duties entailed upon the judicial trustee by the trust

(3) The Court may make, if it thinks fit, special allowances to judicial trustees for the following matters, to be paid out of the trust property—

(a) For the statement of trust property prepared by a judicial trustee on his appointment, an allowance not exceeding ten guineas,

(b) For realising and reinvesting trust property, where the property is realised for the purpose of reinvestment, an allowance not exceeding one and half per centum on the amount realised and reinvested,

(c) For realising or investing trust property in any other case, an allowance not exceeding one per centum on the amount realised or invested

(4) The Court may also in any year make a special allowance to a judicial trustee, if satisfied that in that year more trouble has been thrown upon the trustee by reason of exceptional circumstances than would ordinarily be involved in the administration of the trust.

(5) Where a trustee is remunerated, any allowance under this rule may be paid in addition to his remuneration;

(6) Any remuneration or allowance payable to a judicial trustee shall be paid or allowed to him at such times and in such manner as the Court directs

(c) The Apportionment Act, 1870.

Income Apportionable.

2. From and after the passing of this Act all rents, annuities, dividends, and other periodical payments in the nature of income (whether reserved or made payable under an instrument in writing or otherwise) shall, like interest on money lent, be considered as accruing

from day to day, and shall be apportionable in respect of time accordingly

Interpretation of Terms

5. In the construction of this Act—

The word “rents” includes rent service, rentcharge, and rent seek, and also tithes and all periodical payments or renderings in lieu of or in the nature of rent or tithe

The word “annuities” includes salaries and pensions

The word “dividends” includes (besides dividends strictly so called) all payments made by the name of dividend, bonus, or otherwise out of the revenue of trading or other public companies divisible between all or any of the members of such respective companies, whether such payments shall be usually made or declared at any fixed times or otherwise, and all such divisible revenue shall for the purposes of this Act be deemed to have accrued by equal daily increment during and within the period for or in respect of which the payment of the same revenue shall be declared or expressed to be made, but the said word “dividend” does not include payments in the nature of a return or reimbursement of capital

Cases where Act does not apply

6. Nothing in this Act contained shall render apportionable any annual sums made payable in policies of assurance of any description

7. The provisions of this Act shall not extend to any case in which it is or shall be expressly stipulated that no apportionment shall take place

(f) The Intestates Estates Act, 1890.

Estate not exceeding £500

1. The real and personal estates of every man who shall die intestate after the first day of September, one thousand eight hundred and ninety, leaving a widow but no issue shall, in all cases where the net value of such real and personal estates shall not exceed five hundred pounds, belong to his widow absolutely and exclusively

Estate exceeding £500.

2. Where the net value of the real and personal estates in the preceding section mentioned shall exceed the sum of five hundred pounds, the widow of such intestate shall be entitled to five hundred pounds, part thereof absolutely and exclusively, and shall have a charge upon the whole of such real and personal estates for such five hundred pounds, with interest thereon from the date of the death of the intestate at four per centum per annum until payment.

How Charge to be borne.

3. As between the real and personal representatives of such intestate, such charge shall be borne and paid in proportion to the values of the real and personal estates respectively.

4. The provision for the widow intended to be made by this Act shall be in addition and without prejudice to her interest and share in the residue of the real and personal estates of such intestate remaining after payment of the sum of five hundred pounds, in the same way as if such residue had been the whole of such intestate's real and personal estates and this Act had not been passed.

Valuation of Realty

5. The net value of such real estates as aforesaid shall for the purposes of this Act be estimated in the case of a fee simple upon the basis of twenty years' purchase of the annual value by the year at the date of the death of the intestate as determined by law for the purposes of property tax, less the gross amount of any mortgage or other principal sum charged thereon, and less the value of any annuity or other periodical payment chargeable thereon, to be valued according to the tables and rules in the schedule annexed to the Statute sixteenth and seventeenth Victoria, chapter fifty-one, and in the case of an estate for a life or lives according to the said tables and rules.

Valuation of Personality

6. The net value of such personal estate as aforesaid shall be ascertained by deducting from the gross value thereof all debts, funeral and testamentary expenses of the intestate, and all other lawful liabilities and charges to which the said personal estate shall be subject

Extent of Act.

8. This Act shall not extend to Scotland.

(g) The Trustee Act, 1893.*Authorised Investments.*

1. A trustee may, unless expressly forbidden by the instrument (if any) creating the trust, invest any trust funds in his hands, whether at the time in a state of investment or not, in manner following that is to say:

(a) In any of the Parliamentary Stocks or Public Funds or Government securities of the United Kingdom:

(b) On real or heritable securities in Great Britain, or Ireland:

(c) In the Stock of the Bank of England or the Bank of Ireland:

(d) In India Three and a half per cent. Stock and India Three per cent. Stock, or in any other capital stock which may at any time hereafter be issued by the Secretary of State in Control

- of India under the authority of Act of Parliament, and charged on the revenues of India :
- (e) In any securities the interest of which is for the time being guaranteed by Parliament :
- (f) In Consolidated Stock created by the Metropolitan Board of Works, or by the London County Council, or in Debenture stock created by the Receiver for the Metropolitan Police District :
- (g) In the Debenture or Rent charge, or Guaranteed or Preference stock of any Railway Company in Great Britain or Ireland incorporated by special Act of Parliament, and having during each of the ten years last past before the date of investment paid a dividend at the rate of not less than three per centum per annum on its ordinary stock :
- (h) In the stock of any railway or canal company in Great Britain or Ireland whose undertaking is leased in perpetuity or for a term of not less than two hundred years at a fixed rental to any such railway company as is mentioned in sub-section (g), either alone or jointly with any other railway company :
- (i) In the debenture stock of any railway company in India the interest on which is paid or guaranteed by the Secretary of State in Council of India :
- (j) In the " B " annuities of the Eastern Bengal, the East Indian, and the Scinde Punjaub and Delhi Railways, and any like annuities which may at any time hereafter be created on the purchase of any other railway by the Secretary of State in Council of India, and charged on the revenues of India, and which may be authorised by Act of Parliament to be accepted by trustees in lieu of any stock held by them in the purchased railway ; also in deferred annuities comprised in the Register of Holders of Annuity Class D, and annuities comprised in the Register of Annuitants Class C, of the East Indian Railway Company :
- (k) In the stock of any railway company in India upon which a fixed or minimum dividend in sterling is paid or guaranteed by the Secretary of State in Council of India, or upon the capital of which the interest is so guaranteed :
- (l) In the debenture or guaranteed or preference stock of any company in Great Britain or Ireland, established for the supply of water for profit, and incorporated by special Act of Parliament or by Royal Charter, and having during each of the ten years last past before the date of investment paid a dividend of not less than five pounds per centum on its ordinary stock.
- (m) In nominal or inscribed stock, issued or to be issued by the corporation of any municipal borough having, according to the returns of the last census prior to the date of investment, a population exceeding fifty thousand, or by any county

council, under the authority of any Act of Parliament or Provisional Order :

- (n) In nominal or inscribed stock, issued or to be issued by any Commissioners incorporated by Act of Parliament for the purpose of supplying water, and having a compulsory power of levying rates over an area having, according to the returns of the last census prior to the date of investment, a population exceeding fifty thousand, provided that each of the ten years last past before the date of investment the rates levied by such Commissioners shall not have exceeded eighty per centum of the amount authorised by law to be levied :
- (o) In any of the stocks, funds, or securities for the time being authorised for the investment of cash under the control or subject to the order of the High Court ;

and may also from time to time vary any such investment.

Purchase at a Premium of Redeemable Stocks.

2.—(1) A Trustee may under the powers of this Act invest in any of the securities mentioned or referred to in Section one of this Act, notwithstanding that the same may be redeemable, and that the price exceeds the redemption value.

(2) Provided that a Trustee may not under the powers of this Act purchase at a price exceeding its redemption value any stock mentioned or referred to in Subsections (g), (i), (k), (l), and (m) of Section one, which is liable to be redeemed within fifteen years of the date of purchase at par or at some other fixed rate, or purchase any such stock as is mentioned or referred to in the Subsections aforesaid, which is liable to be redeemed at par or at some other fixed rate, at a price exceeding fifteen per centum above par or such other fixed rate.

(3) A Trustee may retain until redemption any redeemable stock, fund, or security which may have been purchased in accordance with the powers of this Act.

Discretion of Trustees.

3. Every power conferred by the preceding sections shall be exercised according to the discretion of the Trustee, but subject to any consent required by the instrument, if any, creating the trust with respect to the investment of the trust funds.

Application of Preceding Sections.

4. The preceding sections shall apply as well to trusts created before as to trusts created after the passing of this Act, and the powers thereby conferred shall be in addition to the powers conferred by the instrument, if any, creating the trust.

Enlargement of Express Powers of Investment.

5.—(1) A Trustee having power to invest in real securities, unless expressly forbidden by the instrument creating the trust, may invest, and shall be deemed to have always had power to invest—

(a) On mortgage of property held for an unexpired term of not less than two hundred years, and not subject to a reservation of rent greater than a shilling a year, or to any right of redemption, or to any condition for re entry, except for non payment of rent, and

(b) On any charge, or upon mortgage of any charge, made under the Improvement of Land Act, 1864

(2) A Trustee having power to invest in the mortgages or bonds of any railway company or of any other description of company may, unless the contrary is expressed in the instrument authorising the investment, invest in the debenture stock of a railway company or such other company as aforesaid

(3) A Trustee having power to invest money in the debentures or debenture stock of any railway or other company may, unless the contrary is expressed in the instrument authorising the investment, invest in any nominal debentures or nominal debenture stock issued under the Local Loans Act, 1875

(4) A Trustee having power to invest money in securities in the Isle of Man, or in securities of the Government of a Colony, may, unless the contrary is expressed in the instrument authorising the investment, invest in any securities of the Government of the Isle of Man, under the Isle of Man Loans Act, 1850

(5) A Trustee having a general power to invest trust moneys in or upon the security of shares, stock mortgages, bonds or debentures of companies incorporated by or acting under the authority of an Act of Parliament may invest in, or upon the security of, mortgage debentures duly issued under and in accordance with the provisions of the Mortgage Debenture Act, 1865

6. A Trustee having power to invest in the purchase of land or on mortgage of land may invest in the purchase, or on mortgage of any land, notwithstanding the same is charged with a rent under the powers of the Public Money Drainage Acts, 1846 to 1856, or the Landed Property Improvement (Ireland) Act, 1847, or by an absolute order made under the Improvement of Land Act, 1864, unless the terms of the trust expressly provide that the land to be purchased or taken in mortgage shall not be subject to any such prior charge.

Trustee not to hold Certificates to Bearer.

7.—(1) A Trustee, unless authorised by the terms of his trust, shall not apply for or hold any certificate to bearer issued under the authority of any of the following Acts (that is to say) -

(a) The India Stock Certificate Act, 1863,

(b) The National Debt Act, 1870,

(c) The Local Loans Act, 1875 ;

(d) The Colonial Stock Act, 1877.

Loans and Investments not Chargeable as Breaches of Trust.

8.—(1) A Trustee lending money on the security of any property on which he can lawfully lend shall not be chargeable with breach of trust by reason only of the proportion borne by the amount of the loan to the value of the property at the time when the loan was made, provided that it appears to the Court that in making the loan the Trustee was acting upon a report as to the value of the property made by a person whom he reasonably believed to be an able practical surveyor or valuer instructed and employed independently of any owner of the property, whether such surveyor or valuer carried on business in the locality where the property is situate or elsewhere, and that the amount of the loan does not exceed two equal third parts of the value of the property as stated in the report and that the loan was made under the advice of the surveyor or valuer expressed in the report

(2) A Trustee lending money on the security of any leasehold property shall not be chargeable with breach of trust only upon the ground that in making such loan he dispensed either wholly or partly with the production or investigation of the lessor's title

(3) A Trustee shall not be chargeable with breach of trust only upon the ground that in effecting the purchase of or in lending money upon the security of any property he has accepted a shorter title than the title which a purchaser is, in the absence of a special contract, entitled to require, if in the opinion of the Court the title accepted be such as a person acting with prudence and caution would have accepted.

(4) This section applies to transfers of existing securities as well as to new securities, and to investments made as well before as after the commencement of this Act, except where an action or other proceeding was pending with reference thereto on the twenty-fourth day of December, one thousand eight hundred and eighty-eight

Power to Insure Property

18.—(1) A Trustee may insure against loss or damage by fire any building or other insurable property to any amount (including the amount of any insurance already on foot) not exceeding three equal fourth parts of the full value of such building or property, and pay the premiums of such insurance out of the income thereof, or out of the income of any other property subject to the same trusts, without obtaining the consent of any person who may be entitled wholly or partly to such income.

(h) The Colonial Stock Act, 1900.

2. The securities in which a Trustee may invest under the powers of the Trustee Act, 1893, shall include any Colonial stock which is registered in the United Kingdom in accordance with the provisions

of the Colonial Stock Acts, 1877 and 1892, as amended by this Act, and with respect to which there have been observed such conditions (if any) as the Treasury may by order notified in the *London Gazette* prescribe.

The restrictions mentioned in Section 2, Subsection (2), of the Trustee Act, 1893, with respect to the stocks therein referred to, shall apply to Colonial stock. The Treasury shall keep a list of any Colonial stocks in respect of which the provisions of this Act are for the time being complied with, and shall publish the list in the *London and Edinburgh Gazettes*, and in such other manner as may give the public full information on the subject.

§ 13.—Mines in the Stannaries.

(a) The Stannaries Act, 1869.

Interpretation of Terms.

2. In this Act—

The term “the Stannaries” means the Stannaries of Devon and Cornwall:

The term “Company” includes any person or partnership body working a mine in the Stannaries:

The term “Purser” means the Purser for the time being of a Company, and if there is no Purser then the Secretary for the time being, or if there is no Secretary then the principal Agent for the time being of a Company:

The term “Cost Book” includes all books and papers relating to the business of a mine, which are for the time being kept by a Purser, or which, according to the custom of the Stannaries, or the directions of the Company, ought to be kept by him.

Application of Act.

3. This Act extends only to mines within the Stannaries, and subject to the jurisdiction of the Court, or within the cognisance of the Vice-Warden, and nothing in this Act shall extend to Companies registered under any of the Joint Stock Companies Acts, except where such Companies are expressly mentioned or necessarily implied.

Accounts.

9. The Purser of every Company shall, once at least in every four months, truly enter in the cost book of the Company accounts showing the actual financial position of the Company at the end of the financial month of the Company last preceding the time of entry, including a statement of all credits, debts, and liabilities, and distinguishing in such accounts the amount of calls paid and calls not paid, with accurate lists of all the shareholders for the time being in

the Company, with their respective addresses, corrected from time to time as occasion requires, and all other accounts, documents, and things which the Purser is for the time being required to enter therein by the custom of the Stannaries, or by the directions of the Company; and after the passing of this Act all existing or future Companies having any rules or regulations touching the management of the Company or conduct of the business of any mine shall file a true copy of them at the office of the Registrar without payment of any fee; and such rules or regulations shall be subject to the inspection of all applicants at reasonable times, and if any Company shall neglect to file such rules or regulations as above required, then any shareholder in or creditor of any such Company may apply for an order of the Court to file such rules or regulations forthwith, which order shall be enforced by the process of the Court

Audit

10. At any meeting of the Company with special notice the accounts of the Company may be audited, and a call may be made.

(b) The Stannaries Act, 1887

Mine Club Funds

13. —(1) After the commencement of this Act, any custom or rule of law to the contrary notwithstanding, all moneys deducted in any mine from the wages or earnings of or otherwise contributed by the miners for the purposes of a mine club, or accident, or sick or benefit fund, shall, unless a majority of the miners shall by resolution decide otherwise, be deemed to belong to the miners and not to the Company, and the said moneys, and any contributions added thereto by the shareholders, shall be placed to a separate account, and the details thereof, showing the amount received and the several payments thereout, and to whom made during each preceding sixteen weeks, shall be sent out in the balance sheet to be presented to the shareholders at each ordinary meeting, and a copy of the same shall be posted in the miner's dry or changing sheds, and in the account house; and it shall be lawful for the miners in any mine, if they so please, to appoint any two of themselves to audit the said Mine Club Fund Accounts

Accounts.

23. The Purser of every cost book mine shall, once at least every sixteen weeks, truly enter in the cost book of the mine accounts showing the actual financial position of the Company at the end either of the financial month of such Company last preceding the time of entry, or of the calendar month last preceding that time, including a statement of all credits, debts, and liabilities, and distinguishing in such accounts the amounts of calls paid, and calls not paid, and also all other accounts, documents, and things that the Purser is required to enter therein by the custom of the Stannaries or by the direction of the Company.

26. The accounts by the twenty-third section of this Act directed to be entered in the cost book shall, after the same have been laid

before a meeting of the shareholders in pursuance of the twenty-fifth section, be printed, and a copy thereof sent to each shareholder in the Company, and also to the lessors of the mine.

§ 14.—Licensed Properties.

(a) The Licensing Act, 1904.

Renewal of Licences.

1.—(1) The power to refuse the renewal of an existing on-licence, on any ground other than the ground that the licensed premises have been ill-conducted, or are structurally deficient, or structurally unsuitable, or grounds connected with the character or fitness of the proposed holder of the licence, or the ground that the renewal would be void, shall be vested in Quarter Sessions instead of the Justices of the Licensing District, but shall only be exercised on a reference from those Justices, and on payment of compensation in accordance with this Act.

In every case of the refusal of the renewal of an existing on-licence by the Justices of a Licensing District, they shall specify in writing to the applicant the grounds of their refusal.

Payment of Compensation.

2.—(1) Where Quarter Sessions refuse the renewal of an existing on-licence under this Act, a sum equal to the difference between the value of the licensed premises (calculated as if the licence were subject to the same conditions of renewal as were applicable immediately before the passing of this Act, and including in that value the amount of any depreciation of trade fixtures arising by reason of the refusal to renew the licence) and the value which those premises would bear if they were not licensed premises shall be paid as compensation to the persons interested in the licensed premises.

(2) The amount to be so paid shall, if an amount is agreed upon by the persons appearing to Quarter Sessions to be interested in the licensed premises, and is approved by Quarter Sessions, be that amount, and in default of such agreement and approval shall be determined by the Commissioners of Inland Revenue in the same manner and subject to the like appeal to the High Court as on the valuation of an estate for the purpose of Estate Duty, and in any event the amount shall be divided amongst the persons interested in the licensed premises (including the holder of the licence) in such shares as may be determined by Quarter Sessions:

Provided that, in the case of the licence-holder, regard shall be had not only to his legal interest in the premises or trade fixtures, but also to his conduct and to the length of time during which he has been the holder of the licence, and the holder of a licence, if a tenant, shall

(notwithstanding any agreement to the contrary) in no case receive a less amount than he would be entitled to as tenant from year to year of the licensed premises.

(4) Any costs incurred by the Commissioners of Inland Revenue on an appeal from their decision to the High Court under this section shall, unless the High Court order those costs to be paid by some party to the appeal other than the Commissioners, be paid out of the amount to be paid as compensation.

Financial Provisions.

3.—(1) Quarter Sessions shall, in each year, unless they certify to the Secretary of State that it is unnecessary to do so in any year, for the purposes of this Act impose, in respect of all existing on-licences renewed in respect of premises within their area, charges at rates not exceeding and graduated in the same proportion as the rates shown in the scale of maximum charges set out in the First Schedule to this Act.

(2) Charges payable under this section in respect of any licence shall be levied and paid together with and as part of the duties on the corresponding Excise licence, but a separate account shall be kept by the Commissioners of Inland Revenue of the amount produced by those charges in the area of any Quarter Sessions, and that amount shall in each year be paid over to that Quarter Sessions, in accordance with rules made by the Treasury for the purpose.

(3) Such deductions from rent as are set out in the Second Schedule to this Act may, notwithstanding any agreement to the contrary, be made by any licence-holder who pays a charge under this section, and also by any person from whose rent a deduction is made in respect of the payment of such a charge.

(4) Any sums paid under this Act to Quarter Sessions in respect of the charges under this section, or received by Quarter Sessions from any other source for the payment of compensation under this Act, shall be paid by them to a separate account under their management, and the moneys standing to the credit of that account shall constitute the Compensation Fund.

(5) Any expenses incurred by Quarter Sessions in the payment of compensation under this Act, or otherwise in the exercise of their powers or the performance of their duties under this Act, and such expenses of the Justices of the Licensing District incurred under this Act as Quarter Sessions may allow, shall be paid out of the Compensation Fund, and Quarter Sessions, in the exercise of their powers under this Act, shall have regard to the funds available for the purpose.

Quarter Sessions may, with the consent of a Secretary of State, borrow in accordance with Rules made under this Act, on the security of the Compensation Fund, for the purpose of paying any compensation payable under this Act.

Rules.

6.—A Secretary of State may make rules for carrying into effect this Act, and may by those rules, amongst other things—

- (b) provide for the enforcement of any security given for money borrowed, and for the time, not exceeding fifteen years, within which money borrowed is to be replaced; and
- (c) regulate the management and application of the Compensation Fund, and the audit of the accounts of Quarter Sessions

SCHEDULE I.

Scale of Maximum Charges.

Annual Value of Premises to be taken as for the purpose of the Publican's Licence Duty						Maximum Rate of Charge		
£	£					£	s	d.
Under 15	15	.	..	.	..	1	0	0
15 and under 20	20	.			..	2	0	0
20	25	.	.	..	..	3	0	0
25	30	..		.	..	4	0	0
30	40	..	.		..	6	0	0
40	50	..	.		..	10	0	0
50	100	..		..	..	15	0	0
100	200	..		..	..	20	0	0
200	300	..		.	..	30	0	0
300	400	..	..	..	..	40	0	0
400	500	..		..	..	50	0	0
500	600	..			..	60	0	0
600	700	..	.	..	..	70	0	0
700	800	..	..	..	..	80	0	0
800	900	.	.	..	..	90	0	0
900 and over	..	..	..	..	..	100	0	0

SCHEDULE II.

Scale of Deductions.

A person whose unexpired term does not exceed—

1 year, may deduct a sum equal to 100	{ per cent. of the charge.	
2 years	88	"
3 "	82	"
4 "	76	"
5 "	70	"
6 "	65	"
7 "	60	"
8 "	55	"
9 "	50	"

10 years, may deduct a sum equal to	45	{ per cent. of the charge.
11 " " "	41	"
12 " " "	37	"
13 " " "	33	"
14 " " "	29	"
15 " " "	25	"
16 " " "	23	"
17 " " "	21	"
18 " " "	19	"
19 " " "	17	"
20 " " "	15	"
21 " " "	14	"
22 " " "	13	"
23 " " "	12	"
24 " " "	11	"
25 " " "	10	"

Exceeds 25, but does not exceed 30 years, may deduct a sum equal to 7 per cent of the charge

Exceeds 30, but does not exceed 35 years, may deduct a sum equal to 6 per cent of the charge

Exceeds 35, but does not exceed 40 years, may deduct a sum equal to 5 per cent of the charge

Exceeds 40, but does not exceed 45 years, may deduct a sum equal to 4 per cent of the charge

Exceeds 45, but does not exceed 50 years, may deduct a sum equal to 3 per cent of the charge

Exceeds 50, but does not exceed 55 years, may deduct a sum equal to 2 per cent of the charge

Exceeds 55, but does not exceed 60 years, may deduct a sum equal to 1 per cent of the charge

But the amount deducted shall in no case exceed half the rent

(b) The Licensing Rules, 1904.

Accounts.

61.—(1) It shall be the duty of the Compensation Authority to cause proper accounts to be kept in connection with the Compensation Fund, and a Financial Statement to be prepared at the close of each year in the form directed by the Secretary of State.

(2) The accounts shall be made up for each calendar year, or for such other period as the Compensation Authority, with the approval of the Secretary of State, determine.

Audit.

62.—(1) The Compensation Authority shall appoint a professional Accountant, approved by the Secretary of State, to be the Auditor of their accounts.

(2) The Auditor may be appointed for a term not exceeding three years, but a retiring Auditor shall be eligible for reappointment

(3) The remuneration of the Auditor shall be such as may be fixed by the Compensation Authority, with the consent of a Secretary of State

63. As soon as may be after close of the year for which the accounts are made up, the Compensation Authority shall submit to the Auditor for examination the detailed accounts, together with the vouchers and authorities for receipts and payments, and shall also submit, for the Auditor's Certificate, the Annual Financial Statement required by these Rules

64. A copy of the Financial Statement, as certified by the Auditor, shall be sent by the Compensation Authority to the Secretary of State, together with a copy of any Report made by the Auditor in regard thereto.

§ 15.—Territorial and Reserve Forces Act, 1907.

Establishment of Associations.

1.—(1) For the purposes of the reorganisation under this Act of His Majesty's military forces other than the regulars and their reserves, and of the administration of those forces when so reorganised, and for such other purposes as are mentioned in this Act, an association may be established for any county in the United Kingdom, with such powers and duties in connection with the purposes aforesaid as may be conferred on it by or under this Act.

(3) Every such scheme shall provide—

(a) For the date of the establishment of the association;

(b) For the incorporation of the association by an appropriate name, with power to hold land for the purposes of this Act without licence in mortmain

Accounts and Audit

3.—(5) An association shall cause its accounts to be made up annually and audited in such manner as may be prescribed, and shall send copies of its accounts as audited, together with any report of the Auditors thereon, to the Army Council.

(6) Regulations made for the purposes of this section shall be subject to the consent of the Treasury.

Regulations.*Accounts.*

684. An account of the receipt and expenditure of money received from private sources, either for general or specific purposes, will be kept on a suitable form and duly audited.

685. The accounts of an association will be balanced on the 31st March in each year, and a statement on Army Form N. 1524 will be prepared by the association as soon after that date as practicable. This statement will show :—

- (1) The receipts from the Government, from fines, &c., during the year, and, under the appropriate headings, the full expenditure on the authorised services
- (2) The total of the receipts from private sources
- (3) A balance statement showing the financial condition of the association on the 31st March, with
- (4) An explanatory statement of the balances, together with certificates from the bankers, showing the actual state of the several banking accounts at the close of business on the 31st March
- (5) A statement of loans contracted for the benefit of the force.
- (6) Statement of liabilities on the 31st March.
- (7) Statement of assets showing the terms upon which the drill halls and ranges of the force are held, and the amount of money invested or placed on deposit
- (8) A schedule of payments to sergeant-instructors from association funds

Audit.

686. The accounts will be audited by a professional Auditor, appointed subject to the approval of the Army Council. The Auditor will ascertain that the grants from public funds have been appropriated only to the approved purposes specified in paragraph 670 and that all charges are duly vouched. He will also ascertain that proper provision has been made, by sinking fund or otherwise, for the renewal of harness, saddlery, clothing, and equipment. He will not be a person concerned in any way with keeping the accounts of the association nor will he be a member of it. The Auditor must be a member either of an Institute or Society of Chartered Accountants in the United Kingdom or of the Incorporated Society of Accountants and Auditors.

687. The statement of accounts indicated in paragraph 686 will be forwarded to the Army Council not later than the 1st July, in each year, together with the report of the Auditor.

§ 16.—The Port of London Act, 1908.

Accounts and Audit.

24.—(1) As soon as may be after the end of each financial year of the Port Authority the accounts of the Port Authority, and any committee appointed by them, and of their officers, shall be made up to the end of that year and shall be in such form and contain such particulars as may for the time being be prescribed by the Board of Trade, and shall be audited by an Auditor appointed by the Board of Trade:

Provided that—

- (a) The regulations made by the Board of Trade shall provide for the accounts of all sums expended by the Port Authority in erecting, maintaining, and managing warehouses, and of all receipts in respect of the warehousing of goods, being kept distinct from the other accounts of the Port Authority, and for those accounts being audited as a separate section of the accounts of the Port Authority; and
- (b) In prescribing the form of accounts the Board of Trade shall have regard to the desirability of showing separately, so far as practicable, such items of receipts and expenditure on capital and revenue account as are wholly or mainly attributable to the dock undertakings of the Port Authority, and in particular the regulations shall provide that all receipts from port rates on goods discharged from or taken on board ships not within the dock premises of the Port Authority shall be shown separately from the receipts from port rates on goods discharged from or taken on board ships within such premises.
- (2) The Port Authority shall give to the Auditor access to such books and documents as are necessary for the purposes of the audit, and shall, when required, furnish to him all vouchers and information requisite for that purpose, and shall afford to him all facilities for the proper execution of his duty.
- (3) If the Auditor reports to the Board of Trade that the Port Authority have declined or neglected to comply with any of his recommendations or requirements, the Board may, if they think fit, after giving the Port Authority an opportunity of being heard, make an order, directing the Port Authority to comply with such recommendations and requirements, with or without modification, as may be specified in the order.
- (4) Within fourteen days after completion of the audit the Port Authority shall publish an abstract of the accounts, together with any report of the Auditor thereon, in some one or more London newspapers.
- (5) The remuneration of the Auditor shall be such as the Board of Trade direct, and that remuneration and all expenses incurred by him in or about the execution of his duties, to such an amount as the Board of Trade approve, shall be paid by the Port Authority.

§ 17.—Local Authorities.

(a) The Public Health Act, 1875.

Audit where Urban Authority are a Town Council.

246.—Where an Urban Authority are the Council of the Borough the accounts of the receipts and expenditure under this Act of such authority shall be audited and examined by the Auditors of the Borough, and shall be published in like manner, and at the same time, as the municipal accounts, and the Auditors shall proceed in the audit after like notice and in like manner, shall have like powers and authorities, and perform like duties, as in the case of auditing the municipal accounts.

Each of such Auditors shall in respect of each audit be paid such reasonable remuneration, not being less than two guineas for every day in which they are employed in such audit, as such authority from time to time appoint. Any order of such Authority for the payment of any money may be moved by *certiorari*, and like proceedings may be had thereon as under section 44 of the Act of the first year of Her Majesty, Chapter 78, with respect to orders of the council of a borough for payments out of the borough fund.

Audit where Urban Authority are not a Town Council.

247.—Where an Urban Authority are not the Council of a Borough the following regulations with respect to audit shall be observed; (namely)

- (1) The accounts of the receipts and expenditure under this Act of such authority shall be audited and examined once in every year as soon as can be after the twenty-fifth day of March, by the Auditor of accounts relating to the relief of the poor:
- (3) Before each audit such authority shall, after receiving from the Auditor the requisite appointment, give at least fourteen days' notice of the time and place at which the same will be made, and of the deposit of accounts required by this section, by advertisement in some one or more of the local newspapers circulated in the district; and the production of the newspaper containing such notice shall be deemed to be sufficient proof of such notice on any proceeding whatsoever:
- (4) A copy of the accounts, duly made up and balanced, together with all rate books, account books, deeds, contracts, accounts, vouchers, and receipts mentioned or referred to in such accounts, shall be deposited in the office of such authority, and be open during office hours thereat, to the inspection of all persons interested for seven clear days before the audit, and all such persons shall be at liberty to take copies of, or extracts from, the same without fee or reward; and any officer of such authority duly appointed in that behalf neglecting to make up such

- accounts and books, or altering such accounts and books, or allowing them to be altered when so made up, or refusing to allow inspection thereof, shall be liable to a penalty not exceeding five pounds :
- (5) For the purpose of any audit under this Act, every auditor may, by summons in writing, require the production before him of all books, deeds, contracts, accounts, vouchers, receipts, and other documents and papers which he may deem necessary, and may require any person holding or accountable for any such books, deeds, contracts, accounts, vouchers, receipts, documents, or papers to appear before him at any such audit or any adjournment thereof, and to make and sign a declaration as to the correctness of the same ; and if any such person neglects or refuses so to do, or to produce any such books, deeds, contracts, accounts, vouchers, receipts, documents, or papers, or to make or sign such declaration, he shall incur for every neglect or refusal a penalty not exceeding forty shillings ; and if he falsely or corruptly makes or signs any such declaration, knowing the same to be untrue in any material particular, he shall be liable to the penalties inflicted on persons guilty of wilful and corrupt perjury :
- (6) Any ratepayer or owner of property in the district may be present at the audit, and may make any objection to such accounts before the Auditor ; and such ratepayers and owners shall have the same right of appeal against allowances by an Auditor as they have by law against disallowances :
- 7) Any Auditor acting in pursuance of this section shall disallow every item of account contrary to law, and surcharge the same on the person making or authorising the making of the illegal payment, and shall charge against any person accounting the amount of any deficiency or loss incurred by the negligence or misconduct of that person, or of any sum which ought to have been, but is not, brought into account by that person, and shall in every such case certify the amount due from such person, and on application by any party aggrieved shall state in writing the reasons for his decision in respect of such disallowance or surcharge, and also of any allowance which he may have made :
- 8) Any person aggrieved by disallowance made may apply to the Court of Queen's Bench for a writ of *certiorari* to remove the disallowance into the said Court, in the same manner and subject to the same conditions as are provided in the case of disallowances by auditors under laws for the time being in force with regard to the relief of the poor ; and the said Court shall have the same powers with respect to allowances, disallowances, and surcharges under this Act as it has with respect to disallowances or allowances by the said Auditors ; or in lieu of such application any person so aggrieved may appeal to the Local Government Board, which Board shall have the same powers in the case

of the appeal as it possesses in the case of appeals against allowances, disallowances, and surcharges by the said Poor Law Auditors :

- (9) Every sum certified to be due from any person by an Auditor under this Act shall be paid by such person to the treasurer of such authority within fourteen days after the same has been so certified, unless there is an appeal against the decision ; and if such sum is not so paid, and there is no such appeal, the Auditor shall recover the same from the person against whom the same has been certified to be due by the like process, and with the like powers, as in the case of sums certified on the audit of the poor rate accounts, and shall be paid by such authority all such costs and expenses, including a reasonable compensation for loss of time incurred by him in such proceedings, as are not recovered by him from such person :
- (10) Within fourteen days after the completion of the audit, the Auditor shall report on the accounts audited and examined, and shall deliver such report to the clerk of such authority, who shall cause the same to be deposited in their office, and shall publish an abstract of such accounts in some one or more of the local newspapers circulated in the district.

Where the provisions as to audit of any local Act constituting a board of improvement commissioners are repugnant to, or inconsistent with, those of this Act, the audit of the accounts of such improvement commissioners shall be conducted in all respects in accordance with the provisions of this Act.

(b) The District Auditors Act, 1879.

District Auditors.

2.—The whole of the salaries or remuneration, and of the expenses of District Auditors, to such amount as may be sanctioned by the Treasury, shall be paid out of moneys provided by Parliament ; and for the purpose of contributing to the amount required for the payment of such salaries, remuneration, and expenses, there shall be charged on every local authority, whose accounts are audited by a District Auditor, a stamp duty, for the use of Her Majesty, according to the scale contained in the first schedule to this Act, and such duty shall be levied by a stamp on the certificate of the Auditor hereinafter mentioned.

3.—Where the accounts of the receipts and expenditure of a local authority are audited by a District Auditor the local authority shall prepare and submit to the District Auditor at every audit (other than an extraordinary audit held in pursuance of section 6 of the Poor Law Amendment Act, 1860) a financial statement, in duplicate, in the prescribed form, and containing the prescribed particulars ; one of such

duplicates shall have the stamp charged under this Act affixed thereon, and the Auditor at the conclusion of the audit shall cancel that stamp, and certify on each duplicate, in the prescribed form, the amount in words at length of the expenditure so audited and allowed, and further, that the regulations with respect to such statement have been duly complied with, and that he has ascertained by the audit the correctness of the statement.

He shall forthwith send the duplicate so stamped and certified by him to the Local Government Board; and in such case a return of the receipts or expenditure comprised in such statement need not, unless the Local Government Board so require, be sent to the Board in pursuance of the Local Taxation Returns Act, 1860 and 1877.

(c) The Municipal Corporations Act, 1882.

Borough Auditors.

25.—(1) There shall be three Borough Auditors, two elected by the Burgesses, called Elective Auditors, and one appointed by the Mayor, called Mayor's Auditor.

(2) An Elective Auditor must be qualified to be a Councillor, but may not be a member of the Council, or the Town Clerk, or the Treasurer.

(3) The Mayor's Auditor must be a member of the Council.

(4) The term of office of each Auditor shall be one year.

(5) The appointment of the Mayor's Auditor shall be made on the ordinary day of election of the Elective Auditors.

(6) On the casual vacancy in his office an appointment to fill it shall be made within ten days after the occurrence of the vacancy.

Audit and publication of Treasurer's Accounts.

27.—(1) The Treasurer shall within one month from the date to which he is required to make up his accounts in each half-year, submit them, with the necessary vouchers and papers, to the Borough Auditors, and they shall audit them.

(2) After the audit of the accounts for the second half of each financial year, the Treasurer shall print a full abstract of his accounts for that year.

(d) The Local Government Act, 1888.

Accounts and Audit of County Councils.

71.—(1) The accounts of the receipts and expenditure of County Councils shall be made up to the end of each local financial year as

defined by this Act, and be in the form for the time being prescribed by the Local Government Board.

(3) The accounts of a County Council and of the County Treasurer and officers of such Councils, shall be audited by the District Auditors, appointed by the Local Government Board in like manner as accounts of an urban authority, and their officers under sections two hundred and forty seven and two hundred and fifty of the Public Health Act, 1875.

(e) The Local Government Act, 1894.

Accounts and Audit of Parish and District Councils.

58.—(1) The accounts of the receipts and payments of parish and district councils, and of parish meetings for parishes not having parish councils, and their committees and officers, shall be made up yearly to the thirty-first day of March, or in the case of accounts which are required to be audited half-yearly, then half-yearly to the thirtieth day of September, and the thirty-first day of March in each year, and in such form as the Local Government Board prescribe.

(2) The said accounts shall, except in the case of accounts audited by the Auditors of a borough (but inclusive of the accounts of a joint committee appointed by a borough council with another council not being a borough council), be audited by the District Auditor, and the enactments relating to audit by District Auditors of accounts of urban sanitary authorities and their officers, and to all matters incidental thereto and consequential thereon, shall apply accordingly, except that in the case of the accounts of rural district councils, their committees and officers, the audit shall be half-yearly instead of yearly.

(3) The Local Government Board may, with respect to any audit to which this section applies, make rules modifying the enactments as to publication of notice of the audit, and of the abstract of accounts and the report of the Auditor.

(f) The London Government Act, 1899.

Accounts and Audit of Metropolitan Boroughs.

(14) After the appointed day the accounts of the Council of every Metropolitan Borough, and of any committee appointed by the Council, and of their officers, including the accounts relating to the making, levy, and collection of any rate made by the Council, shall be made up and audited in like manner and subject to the same provisions as the accounts of the London County Council, and the enactments relating to the audit of those accounts and to all matters incidental thereto and consequential thereon, including the penal provisions, shall apply accordingly.

(g).The Metropolis Water Act, 1902.*Accounts and Audit of Metropolitan Water Board.*

. 19.—The accounts of the Water Board, and any committee appointed by them, and of their officers, shall be made up and audited in like manner, and subject to the same provisions, as the accounts of County Councils, except that a water consumer shall have the same right of being present at the audit, and of making objections and appealing, as a ratepayer has, and that the stamp duty charged on the Water Board for the purposes of the District Auditors Act, 1879, shall be such as the Treasury, after consultation with the Local Government Board, and having regard to the cost of the audit, may determine, and the enactments relating to the accounts of County Councils and the audit thereof, and to all matters incidental thereto and consequential thereon including the penal provisions, shall apply accordingly.

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